

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)	
)	
Tariffs and charges submitted pursuant to)	Docket No. 11-0721
Section 16-108.5 of the Public Utilities Act.)	
)	

INITIAL BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS
and AARP

The People of the State of Illinois

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The People of the State of Illinois, by LISA MADIGAN, Attorney General of the State of Illinois (the “People,” or “AG”) and AARP, through its counsel, pursuant to the Commission’s rules, 83 Ill. Admin. Code 200.800 and the schedule established by the Administrative Law Judges, file their Initial Brief in response to the request by Commonwealth Edison Company (“ComEd”) to opt into formula rate regulation under Section 16-108.5 of the Public Utilities Act (“PUA” or “the Act”) and to set initial rates to become effective for the June, 2012 billing cycle.

I. INTRODUCTION / STATEMENT OF THE CASE

A. The New Section 16-108.5 Created A New Statutory Structure For Determining the Utility’s Revenue Requirement

This docket is the first filing by ComEd under the 2011 amendments to the Public Utilities Act that added new section 16-108.5 and 16-108.6. The changes to these sections were contained in two bills: SB 1652, which became effective as Public Act 97-0616 on October 26, 2011, and HB 3036, which became effective as Public Act 97-0646 on December 30, 2011. Because HB 3036 revised some provisions of PA 97-0616, the terms of HB 3036 control when there is a conflict between the bills.¹

Section 16-108.5 allows ComEd to request special rate treatment upon committing to invest a total of \$2.6 billion over a 10 year period, meet certain job creation requirements, and establish a customer assistance program. 220 ILCS 5/16-108.5(b) & (b)(1)(A)& (b-10). The new section describes the special rate treatment as:

a performance-based formula rate approved by the Commission, which shall specify the cost components that form the basis of the rate charged to customers with sufficient specificity to operate in a standardized manner and be updated annually with transparent information that reflects the utility’s actual costs to be recovered during the

¹ Many of the paragraphs of Section 16-108.5 are unnumbered and some subsections, such as subsection (c) extend over several pages. HB 3036 Enrolled is a paginated version of the law, and is available at: <http://www.ilga.gov/legislation/fulltext.asp?DocName=09700HB3036enr&GA=97&SessionId=84&DocTypeId=HB&LegID=60385&DocNum=3036&GAID=11&Session=> Page references to HB 3036 Enrolled will be footnoted.

applicable rate year, which is the period beginning with the first billing day of January and extending through the last billing day of the following December.

220 ILCS 5/16-108.5(c). The statute also includes provisions regarding the ratemaking treatment of various components of the formula, including capital structure, 220 ILCS 5/16-108.5(c)(2); cost of equity, *id.* at (c)(3); an earnings collar, *id.* at (c)(5); various “protocols” or ratemaking factors, such as treatment of incentive compensation, pension and post-employment benefits expenses, severance costs, amortization over five years of costs that exceed \$10 million, and allocation methods for common costs. *id.* at (c)(4)(A)(B)(C)(F) & (I).

The statute directs the utility make an annual filing on or before May 1 that includes “updated costs inputs” for the formula and “the corresponding new charges.” The inputs, or costs, are based on “final historical data reflected in the utility’s most recently filed annual FERC Form 1 plus projected additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed.” *Id.* at 16-108.5(d).² As a result, each year subsequent to the establishment of the formula, the utility files new costs and new rates. This differs from current practice where rate changes are only requested when the utility finds that revenues do not provide an acceptable profit margin.

In addition to establishing annual rate changes, Section 16-108.5 grants the utility the extraordinary right to reconcile the revenue requirement set for the prior year with actual costs incurred in that year, and to either apply a surcharge or a credit to consumers’ bills to provide the utility with “what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the time of filing.” 220 ILCS 5/16-108.5(c)(6). In general, the formula is supposed to:

² HB 3036 Enrolled, page 40.

Provide for the recovery of the utility's actual costs of delivery services that are prudently incurred and reasonable in amount consistent with Commission practice and law. The sole fact that a cost differs from that incurred in a prior calendar year or that an investment is different from that made in a prior calendar year shall not imply the imprudence or unreasonableness of that cost or investment.

Id. at (c)(1).³

Section 16-108.5 establishes a cycle of rate filings that needs to be understood to effectively resolve some of the contested issues in this docket. This first filing sets the details of the formula, and the inception revenue requirement for 2012 based on 2010 data. There is no reconciliation in this docket. The schedule of subsequent filings will be as follows:

	Utility Filing	Result
November 8, 2011	Formula and initial rates established based on 2010 FERC Form 1 inputs filed	Inception 2011 revenue requirement and rates based on 2010 FERC Form 1 cost inputs plus 2011 plant additions, established on May 31, 2012
May 1, 2012	Formula with FERC Form 1 2011 inputs, plus plant additions for 2012; Inception revenue requirement reconciled with “actual” revenue requirement for 2011 based on 2011 FERC Form 1 inputs and added to total 2012 revenue requirement with interest.	
December 31, 2012		Inception 2012 revenue requirement and rates finalized to be charged in calendar year 2013, based on: <ul style="list-style-type: none"> • FERC Form 1 2011 inputs • Plant additions for 2012

³ HB 3036 Enrolled at 31.

		<ul style="list-style-type: none"> • Reconciliation factor reflecting “actual” revenue requirement for 2011 based on the difference between “inception” 2011 revenue requirements set in current docket and cost inputs from FERC Form 1 for 2011.
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The statute is premised on the determination of revenue requirements based on “actual” FERC Form 1 costs. However, FERC Form 1 reports are inherently historical, reporting the prior year’s results of operations. Accordingly, the revenue requirement for a given year is subject to “reconciliation” to capture the actual data included in the FERC Form 1. This brief will refer to the “inception” revenue requirement and the reconciled revenue requirement as necessary.

B. The Formula and Revenue Requirement ComEd Filed on November 8, 2011 Contain Provisions that Overstate Both Its Inception and Its Reconciliation Revenue Requirement and Rates.

ComEd filed its proposed formula rate structure, protocols and initial revenue requirement and rates, and the Commission suspended the filing and initiated this docket on November 8, 2011. The statute requires a Commission order “approving, or approving as modified, the performance-based formula rate, including the initial rates” by May 31, 2012. 220 ILCS 5/16-108.5(c).⁴ The Commission is directed to “conduct an investigation of the tariff in a manner consistent with the provisions of this subsection (c) and the provisions of Article IX of this Act to the extent they do not conflict with this subsection (c).” *Id.* “Such

⁴ HB 3036 Enrolled at 37.

review shall be based on the same evidentiary standards, including but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act.”⁵ Initial rates are to take effect within 30 days after the Commission approves the formula tariff. *Id.*⁶

This docket involves essentially three parts:

- First, Commission review of ComEd’s proposed formula rate proposal, including the regulatory treatment of various rate base and expense items.
- Second, the Commission must determine the 2011 revenue requirement that will result from the application of the formula for rates effective in June, 2012. The Commission must determine whether the costs reflected in the 2010 FERC Form 1 and the resulting rates are just, reasonable and prudent and comply with Commission practice. This includes review of the accounting treatment of various costs as well as whether the specific amounts requested are reasonable and prudent. The key issues raised by the People are the treatment of accumulated deferred income taxes, operating reserves, cash working capital, jurisdictional allocations (between the FERC and the ICC jurisdictions), incentive compensation, discretionary management retention awards and perquisites, charitable contributions, and the new business revenues adjustment to the 2011 billing determinants to reflect 2011 plant additions. Staff and other parties have raised other adjustments. The People reserve the right to comment on other parties’ positions in their Reply Brief.

⁵ HB 3036 Enrolled at 37.

⁶ *Id.*

- Third, the Commission must establish how the reconciliation will work in the next formula rate filing. An annual reconciliation of the total revenue requirement guarantees the utility full recovery of all reasonable and prudent costs. It removes the incentive inherent in test year ratemaking to achieve efficiency between rate cases, and creates a “cost plus” method of regulation. This extraordinary reconciliation must be considered on its own terms, independent of how rates are set under a traditional test year where rates are expected to remain in effect for several years. The key reconciliation issues are: the use of average rate base in the reconciliation to accurately reflect capital costs throughout the year rather than a year-end rate base, which will overstate rate base by adding capital costs for the entire year as if the cumulative year-end investment level had been maintained all year; the use of historical billing determinants in the reconciliation, and the appropriate interest rate to apply to any credit or surcharge resulting from the reconciliation amount.⁷

In summary, this docket addresses both the extraordinary challenge of determining the details of formula regulation and reconciliation required by Section 16-108.5 and the more traditional job of determining just, reasonable and prudent costs and rates.

II. OVERALL REVENUE REQUIREMENT

ComEd’s revenue requirement formula under Section 16-108.5 is fundamentally the same formula traditionally used by the Commission to set rates, but with some components

⁷ Section 16-108.5(c)(6) states that the formula must “[p]rovide for an annual reconciliation, with interest as described in subsection (d) of this Section.” HB 3036 Enrolled at 36. Subsection (d) provides: “Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest, the charges for the applicable rate year.” *Id.* at 40.

defined by the statute. As ComEd witness Houtsma testified: “ComEd’s formula rate follows the well-established revenue requirement formula: Revenue Requirement = (Rate of Return x Rate Base) + Operating Expenses, and incorporates the added directives set forth in Section 16-108.5(c) of the Public Utilities Act.” ComEd 2.0 at 4, 9-10. See, e.g., *Business and Professional People in the Public Interest v. Illinois Commerce Commission*, 146 Ill.2d 175, 195 (1991) (describing components of the revenue requirement formula). The rate of return is established by Section 16-108.5(c)(3) &(d)(1), and the rate base is the historical rate base reported in the FERC Form 1 for the prior year, “plus plant additions and correspondingly updated depreciation reserve and expense for the calendar year in which the tariff and data are filed.” 220 ILCS 5/16-108.5(c).⁸ Unlike the current system, under Section 16-108.5 an inception revenue requirement is (1) set every year based on the prior year’s FERC Form 1 data and (2) the inception revenue requirement is later reconciled with “actual” cost data from the FERC Form 1 for the inception year, with the reconciliation charge or credit (with interest) added to the following year’s total (inception) revenue requirement. *Id.* at 16-108.5(c)(6) &(d)(1).

ComEd witnesses presented a revenue requirement and schedules reflecting the latest amendments to Section 16-108.5. The “trailer bill” revenue requirement was initially identified by ComEd as \$2,030,391. ComEd Ex.1.0 at 19 & ComEd Ex. 4.0 at 10. On Surrebuttal, ComEd reduced its requested revenue requirement to \$2, 024,932,000. ComEd Ex. 22.1, Sch. FR A-1.⁹ Although ComEd reduced its requested revenue requirement, it has not included all of the adjustments necessary both to comply with the law and to adjust costs to reasonable and prudent levels.

⁸ HB 3036 Enrolled at page 37, lines 2-5.

⁹ The “trailer bill” was signed on December 31, 2011, and ComEd used the terms of that law in its Surrebuttal calculations.

The People retained two regulatory accounting experts to analyze ComEd's formula and costs of service for 2011. Their analyses do not include all aspects of ComEd's cost of service and do not include all of the appropriate adjustments recommended by Staff and other parties. The People's recommendations should be view as cumulative to the work and recommendations of Commission Staff and other parties. AG/AARP Ex. 1.0 at 5. As shown on AG/AARP Ex. 1.3, page 1, the adjustments identified by AG/AARP witnesses Michael Brosch and David Effron would reduce ComEd's overall revenue requirement by \$119,389,000 or 5.7%, as more particularly set out below:

ComEd 2011 Revenue Requirement, pro-rated between pre- and post- 10-0467 Order revenue requirement:	\$2,084,072,000
Revenue Requirement per AG/AARP Ex. 1.3, page 1	\$1,964,683,000
Net reduction	\$ 119,389,000

There is no reconciliation in this docket because this is the first formula rate revenue requirement under the new law.

III. RATE BASE

A. Overview

For formula ratemaking purposes, the rate base is the investment in property used to provide distribution service to customers for which the utility incurs a cost. If funds are not obtained from either investors or creditors, the investment amount must be removed from rate base. Funds received or retained by the utility as a result of customer deposits, accumulated deferred income taxes (ADIT), and operating reserves are among the funds commonly deducted from rate base due to the fact that these funds are not supplied by investors or creditors and therefore consumers should not be asked to pay a return on it.

AG/AARP witnesses Effron and Brosch identified the following rate base adjustments, representing non-investor supplied funds:

ADITS¹⁰

Bad Debt	(\$19,440,000)
Accrued Vacation	1,678,000
Accrued Incentive Pay	(8,908,000)
Plant Additions	(265,681,000)
TOTAL	(292,350,000)

OPERATING RESERVES¹¹

Accrued Vacation	(43,341,000)
Accrued Incentive Pay	(10,562,000)
TOTAL	(53,903,000)

CASH WORKING CAPITAL¹² (86,564,000)

TOTAL RATE BASE ADJUSTMENTS PER AG/AARP (\$432,817,000)

Staff and other parties have recommended several additional rate base adjustments.

B. Potentially Uncontested Issues

The People will not comment on “potentially uncontested” rate base issues.

C. Potentially Contested Issues

1. Average Year or End of Year Rate Base (see also VIII.C.1)

As noted above, in each year subsequent to this initial filing, the Commission will determine both the *inception* revenue requirement for the year and the *actual* revenue requirement for the prior year. In this section, the question is how to determine the rate base for the *inception* revenue requirement. Section 16-108.5(d) provides that in setting the inception revenue requirement (subject to later reconciliation), rate base “shall be based on final historical data reflected in the utility’s most recently filed annual FERC Form 1 plus projected plant

¹⁰ AG/AARP Ex. 4.0, Sch. DJE-1R

¹¹ *Id.*

¹² AG/AARP Ex. 3.4, line28.

additions and correspondingly updated depreciation reserve and expense for the calendar year in which the inputs are filed.” Therefore, the rate base will be a mix of historical rate base and projected plant additions.

The Company’s proposed formula uses end-of-year plant inputs from the FERC Form 1 subject to various adjustments including projected plant additions, to set the *inception* rate base. See ComEd Ex. 22.1, Sch. FR-B1. The People do not object to using end-of-year FERC Form 1 plant data for the inception revenue requirement and note that projected plant additions are added to that end-of-year value. The use of end-of-year historical data (e.g. 2010), plus projected plant values (for 2011), is consistent with the goal of setting an (2011) inception revenue requirement as close to the actual rate base for the (2011) inception year as possible. However, this does not lead to or mandate the use of end-of-year FERC Form 1 values in the *reconciliation*, as will be discussed below at Section VIII.C.1.

ComEd witness Houtsma admits that the use of end-of-year plant is nowhere mentioned in Section 16-108.5.¹³ Section 16-108.5(c) allows the utility to “elect to recover its delivery services costs” through a formula which specifies the cost components that make up the revenue requirement, that can operate in a standardized manner, that can be updated annually, and that “reflects the utility’s actual costs.”¹⁴ The statute directs that the formula include many specific terms. However, nowhere in the statute is the calculation of rate base specified. See 220 ILCS 5/16-108.5(c)(1)-(5).¹⁵ Nevertheless, the People do not object to ComEd’s proposal to use FERC Form 1 year-end plant values in setting the inception rate base.

2. Plant-in-Service

¹³ ComEd Ex. 12.0 at 32-33; ComEd Ex. 21.0 at 21-22.

¹⁴ HB 3036 Enrolled at 29.

¹⁵ *Id.* at 31-36.

a) Original Cost Finding 2010 Plant

b) 2010 General and Intangible Plant Functionalization

Section 16-108.5 directs the Commission to “[p]ermit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law” in its review of a proposed formula tariff. 220 ILCS 5/16-108.5(c)(4). Among the protocols to be included in the formula are “allocation methods for common costs.” *Id.* at 16-108.5(c)(4)(I). No further direction regarding the allocation of common costs is contained in the statute.

In its proposed formula, ComEd includes both “general” plant and “intangible plant” values from its FERC Form 1 as well as allocations of that plant. ComEd Ex. 22.1, Sch. FR-B1, Lines 5-16. While ComEd has both interstate transmission operations subject to the FERC jurisdiction and in-state distribution operations subject to regulation by the Commission, portions of its General and Intangible Plant (“G&I Plant”) are used in both jurisdictions. Accordingly, the costs associated with this common plant must be divided, or “allocated” so that appropriate portions of the common costs are included in the Illinois distribution revenue requirement.

In ComEd’s last rate increase request, ICC Docket 10-0467, which concluded less than a year ago, ComEd requested that the Commission change the G&I Plant allocation. In its Final Order at pages 40-42, the Commission discussed ComEd’s request but concluded that it would retain the existing allocations. ICC Docket 10-0467, Order at 40-42 (May 24, 2011).

In its formula proposal in this docket, ComEd seeks to change the allocations of G&I Plant from that adopted by the Commission in its Docket 10-0467 Order. By contrast, AG/AARP witness Brosch, Staff witness Rukosuev, and CUB witness Smith all recommend that the Commission retain the allocation methods applied by the Commission in the Docket 10-0467 Order. See, Tr. at 996 & ComEd Ex. 12.0 at 22-24. The People maintain that the use of the

existing allocations of G&I Plant is “consistent with Commission practice and law” under Section 16-108.5(c)(4) and that the formula should be modified to reflect the existing allocation methods.

(1) Methodologies

According to the Commission’s Order in Docket 10-0467, the current allocations are a “combination of generic functional allocators and direct assignment approved by the Commission in Dockets Nos. 08-0532, 07-0566 and 05-0597.” Order at 40. ComEd Exhibit 12.0 at page 23 shows the various factors that are currently used to determine the appropriate allocations. By contrast, in its formula, ComEd seeks to use the “Wages and Salaries” allocator for non-Communications plant, which it claims will simplify the allocation. ComEd Ex. 2.0 at 29. However, there have been no changes in the underlying assets or in how they are used to justify a departure from current practice. Tr. at 1007-1008.

ComEd witness Houtsma recognizes that jurisdictional allocation involves the use of judgment and that the Wages and Salaries allocator “is not the only possible method.” ComEd Ex. 2.0 at 29. However, the nature of ComEd’s proposed allocations calls into question whether the Wages and Salaries allocator is always appropriate. For example, ComEd would change the allocation of Tools, Shop and Garage Equipment (Account 394) from a plant-based allocation to a Wages and Salaries allocator. ComEd’s approach would increase the allocation to Illinois consumers by \$7,090,791 without any evidence that Wages and Salaries corresponds more closely than the Gross Plant Allocator with the use of “Tools, Shop and Garage Equipment.” In the absence of a study to the contrary, there is no reason to believe that wages and salaries paid to non-plant related personnel has any relationship whatsoever. The relatively large payroll expense for Customer Accounts and Administrative and General shown on ComEd’s Schedule

C-11.1, who would not use “tools, shop, and garage equipment,” calls into question the use of that allocator. As Ms. Houtsma candidly stated: “Neither method is perfect, although both can be considered reasonable.” ComEd Ex. 2.0 at 29.

ComEd witness Houtsma also argues that the change in jurisdictional allocations is appropriate so that the Illinois allocation methods match or be consistent with the federal allocation methods. ComEd Ex. 2.0 at 29-30. ComEd has control over the allocation methods it proposes at the FERC level, and can choose to either propose to change the Illinois allocation or change the FERC allocation. ComEd has not presented a compelling reason to change the cost-based and well-established allocations used in Illinois.

(2) W&S Allocator Calculation (see also V.C.1.e)

The People recommend that the Commission modify ComEd’s formula rate tariff to incorporate the current jurisdictional allocation methods. As a result of retaining existing allocations, there will be increases and decreases to net plant, as shown on AG/AARP Exhibit 1.10, page 7 (Bates stamp number CFRC 0015295) and ComEd Exhibit 12.0 at 24. Retaining current allocation methods will decrease net plant by \$18,196,790 and reduce the depreciation expense by \$492,000. These revenue requirement effects are shown on AG/AARP Exhibit 1.3, column D and equal \$5,865,000.

- c) **2011 Plant Additions**
- d) **Derivative: Restricted Stock**
- e) **Derivative: Incentive Compensation**
- f) **Derivative: Perquisites and Awards**
- 3. **Accumulated Depreciation & Amortization**
- 4. **Cash Working Capital Issues**

Cash Working Capital (“CWC”) is the amount of funds required from investors to finance the day-to-day operations of a company. In other words, CWC reflects the amount of cash a company needs to invest to pay its cash operating expenses after taking into account the

timing of receipt of its cash revenues. A company's CWC requirement may be positive or negative, depending on whether revenues are received, on average, slower or faster than expenses are paid. ICC Ex. 3.0 at 3-4.

The amount of CWC to be included in a utility's rate base, is most accurately determined based on a lead-lag study. A lead-lag study analyzes the timing of payments for goods and services compared to the date the goods and services were received, and also analyzes the date customers received utility services and the date that the company received payment from customers. Lag times are associated with the collection of cash revenues owed to the Company. Lead times are associated with the cash payments for goods and services received by the Company; for example, vendors typically allow the Company to pay for goods and services after the goods and services were received. Thus, if the revenue lag to collect cash from customers exceeds the expense lead allowing the Company to delay cash outlays for the provision of service, there will be a positive CWC. *Id.* at 4. Alternatively, if ComEd collects revenues from customers faster than it pays for services to vendors, its CWC balance is negative. Tr. at 238. It should be noted that approval of a positive CWC allowance is not a given. For example, the Company did not request any adjustment to its rate base for CWC in its 2007 rate case. *See* ICC Docket 07-0566, *Commonwealth Edison Company – Proposed general increase in electric rates*, Order of September 10, 2008 at 51.

In this case, the Company requests an allowance for Cash Working Capital ("CWC") of \$38.1 million, which would be added to the Company's rate base, as set forth in ComEd Ex. 25.1. This amount is based upon a lead-lag study of CWC sponsored by ComEd witness John Hengtgen, a consultant from SFIO Consulting. ComEd Ex. 8.0 at 1. Staff witness Daniel Kahle, AG/AARP witnesses Michael Brosch and David Effron, CUB witness Ralph Smith and IIEC

witness Michael Gorman each found significant flaws in the lead-lag study presented by Mr. Hengtgen. All concluded that significant modifications to ComEd's calculation of CWC are necessary in order to prevent ratepayers from needlessly paying millions of dollars each year for cash capital that is overstated in the Company's lead lag study.

Pursuant to both traditional and formula rate regulatory review established in the Act, ComEd carries the burden of proving the justness and reasonableness of its proposed ratemaking methodologies. 220 ICLS 5/ 9-201, 16-108.5(c). The formula rate structure in no way abrogates the Commission's responsibility to investigate the reasonableness of the formula itself or the expense and rate base elements that populate it. Section 16-108.5(c) specifically provides:

After the utility files its proposed performance-based formula rate structure and protocols and initial rates, the Commission shall initiate a docket to review the filing. The Commission shall enter an order approving, or approving as modified, the performance-based formula rate, including the initial rates, as just and reasonable within 270 days after the date on which the tariff was filed, or, if the tariff is filed within 14 days after the effective date of this amendatory Act of the 97th General Assembly, then by May 31, 2012. Such review shall be based on the same evidentiary standards, including, but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility, the Commission applies in a hearing to review a filing for a general increase in rates under Article IX of this Act.

220 ILCS 5/16-108.5(c).

As discussed below, ComEd simply failed to meet their burden of proving the reliability and reasonableness of the assumptions and calculations used by Mr. Hengtgen in his lead-lag study that is the basis for the Company's CWC presentation. Mr. Brosch recommends several changes to the ComEd lead-lag study for purposes of establishing the inception rates that will later be subject to reconciliation, to reflect a more precise estimate of the Company's actual

CWC needs. The ComEd-proposed lead-lag study and CWC presentation should be modified to reflect the following changes and then employed to set rates:

1. Revision of ComEd's estimated revenue collection lag to remove the uncollectible accounts portion of Accounts Receivables used in ComEd's calculation, which represent receivables that will not be collected at all, and therefore cannot impact the timing of ComEd's cash flows.
2. Removal of non-cash Pension and OPEB accrued expense amounts from the "Receipts" to which a revenue lag value is improperly applied by ComEd.
3. Insertion of the Commission's Docket No. 10-0467 ordered payment lead for intercompany transactions, to avoid potential cross-subsidization of affiliate transactions.
4. Reinstatement of the Commission's ordered treatment of pass-through taxes, assigning no revenue lag to these amounts where ComEd serves as the collection agent and no tax is owed until after revenues are collected by ComEd.
5. Correction of ComEd's inappropriate application of the calculated "Other O&M" payment lead value to CWIP-related Accounts Payable balances.

Id. at 26. Importantly, Mr. Brosch further recommends that, before any CWC allowance is permitted in future formula rate changes or as part of the reconciliation of 2011 revenue requirements to actual costs in the Company's May 2012 filing, ComEd be ordered to conduct a more extensive analysis of its actual revenue collection lag days and revise the CWC calculations to reflect the results of such study, as more fully described below.

a) Revenue Collection Lag

The largest of many disagreements between ComEd and AG/AARP involves the accuracy and reliability of ComEd's methodology used by Mr. Hengtgen to estimate the Revenue Lag in the lead-lag study. The Revenue Lag represents the number of days ComEd must wait to collect cash after service is provided to customers, measured from the date service is rendered by the Company until the date payment is received from customers and such funds become available to ComEd.

ComEd's proposed Revenue Lag is comprised of five segments, including:

1. A customer usage or service period lag of 15.21 days;
2. An average billing period lag of 2.06 days;
3. A collection lag between the billing date and customer remittances estimated at 32.24 days by ComEd;
4. A payment processing lag for processing and depositing of remittances; and
5. A bank float of 0.79 days until deposited funds are available for use by ComEd.¹⁶

AG/AARP witness Brosch testified that there are major problems with the third element of the Company's calculation that must be corrected. The revenue collection lag underlying the asserted CWC amounts is being estimated by Mr. Hengtgen through application of "very crude assumptions to broad categories of month-end accounts receivable balances." AG/AARP Ex. 1.0 at 23. Mr. Hengtgen's methodology employs 13-month-end Accounts Receivables balances that are averaged. Tr. At 241. But rather than employ any kind of an analysis to determine when revenues actually are received by ComEd among the various customer categories, Mr. Hengtgen, with few exceptions, either simply selected the mid-point of each broadly defined Accounts Receivables aging interval or, after deducting the grace period¹⁷ from each aging interval created and selected the mid-point of the time remaining in each aging interval time increments. Tr. At

¹⁶ ComEd Ex. 8.0, p. 7:130 – p. 10:178.

¹⁷ A grace period is defined as the amount of time a customer class has to pay the bill. Tr. at 246.

244. In short, neither Mr. Hengtgen nor ComEd actually measures how long it takes the Company to collect revenues from its customers. Instead, the Company looks to a breakdown of its month-end Accounts Receivable balances by customer class and assigns, without any supporting analysis, arbitrarily assumed revenue collection dates to each grouping of aged receivable balances. *Id.* At 23. Table 1, below, illustrates ComEd’s crudely applied methodology, which assigns each interval of days listed at the top of the columns an approximate mid-point collection date:

Receivable Age>>	0 – 30	31 – 60	61 – 90	91 – 120	121 – 150	151 – 180	181 – 210	211 – 270	271 – 365
Residential	0	45	75	105	135	165	195	240	317.5
SCI	8	45	75	105	135	165	195	240	317.5
LCI	8	45	75	105	135	165	195	240	317.5
Railroad	0	0	15	45	75	105	135	165	287.5
Street Lighting	0	0	15	45	75	105	135	165	287.5
Public Authority	0	0	15	45	15	45	75	105	287.5
Government	0	8	45	75	105	135	165	195	302.5

AG/AARP Ex. 1.0 at 23. For example, all of the residential customer accounts with balances owed that were 31-60 days old were assumed be paid precisely at the mid-point of this period, on day 45, and all residential customer accounts with balances 61-90 days old are assumed to be fully paid to ComEd precisely on day 75, which is again the mathematical mid-point of the period. Similar “mid-point” assumptions were employed throughout ComEd’s calculations, with no further analysis to determine within these broad aging categories when customers, on average, are *actually* paying their bills. *Id.* At 24.

ComEd employs equally makeshift “grace period” assumptions, which cause several early aging categories of Accounts Receivable to arbitrarily deviate from consistent use of the Company’s mid-point assumptions that are employed elsewhere. For example, ComEd assigns

an assumed zero lag value to all residential balances 0-30 days old and assigns an 8 day value to small commercial and industrial (“SCI”) and large commercial and industrial (“LCI”) accounts falling within the same aging category. It is highly unlikely that all of the commercial customers in the SCI and LCI classes that pay their bills within 30 days also happen to elect to pay on exactly day number 8 in that aging group, as assumed by ComEd. Mr. Brosch further testified that it is factually impossible for all the residential customers who pay within the first 30 days after their bills are rendered to have actually paid on day number zero, as assumed by ComEd. *Id.*

The Company’s response to this recommendation was simple, if not stubbornly trite. When asked, for example, if ComEd knew or had calculated averages of ComEd’s daily outstanding receivables after daily processing of billings and remittances, ComEd CWC witness Hengtgen that “that information is not available.” Tr. At 241-242. When asked whether he had done any kind of specific analysis to determine when residential remittances are paid, for example, after 5 days, or 10 days or 15 days after the bill has been forwarded to the customer, he stated “No, that information is not available. Tr. At 243.

Indeed, Mr. Hengtgen confirmed he employed arbitrary assumptions in his analysis of the timing of residential account remittances, including the postulation that there is no CWC requirement associated with the nearly \$210 million of average residential accounts receivables that are less than 30-days old. When it came to the 31-60-day period, again Mr. Hengtgen conducted no specific evaluation or statistical sampling of the timing of remittances during that 31-to-60-day period. Tr. 244. Again, he claimed, “that type of information is not available.” *Id.* He stated that “the Company does not know the actual dispersion of all the payments during the

month,” (because it performs no such analysis) so he reflected the midpoint of the days remaining after the grace period ended. Tr. At 245.

The same kind of arbitrary assumptions were employed in other customer classes. For the railroad, street lighting and public authority customer groups, Mr. Hengtgen made no analysis as to whether these customers remit their payments prior to the grace period deadline. Tr. At 248. Mr. Hengtgen admitted that he is unaware of any statistical regularity in the remittance of receivables on any defined basis for that time period. *Id.* At 249. With respect to the Government ratepayer class, a zero midpoint is listed because the grace period for that category of customers is longer than that age interval.¹⁸ *Id.* Again, all of these random assignments of remittance dates were performed because Mr. Hengtgen insists, “the data isn’t available.” Tr. At 250. But it is not that such an analysis is impossible to perform. Indeed, Mr. Hengtgen agreed that it is possible to perform such a statistical sampling. *Id.* ComEd simply has chosen not to perform a statistical analysis that would take a sampling of the remittances from each of these customer classes to try and determine more specifically when customer payments are received by the Company. *Id.*

The revenue requirement impact of the revenue collection lag component of CWC cannot be understated. Mr. Hengtgen confirmed that a single, one-day change in the revenue collection lag alters the CWC requirement by \$4.9 million. Tr. At 258-260. This fact highlights the importance of requiring the Company to perform a more precise quantification of CWC

¹⁸¹⁸ Mr. Hengtgen revealed the true random and arbitrary nature of his pick-a-point assumptions when ALJ Sainsot asked, in a moment of levity, whether the Government ratepayer class actually “pays its bills on time.” Tr. at 267. Mr. Hengtgen explained, acknowledging his incorporation of the assumption that grace periods are first subtracted from the number of days in an aging interval, responded, “What that represents is the use of the grace periods in those first categories.” *Id.* ALJ Sainsot further inquired, “So, technically they do?” Mr. Hengtgen, notably, responded, “According to the assumptions I made in the study.” Tr. at 267-268. Of course, Mr. Hengtgen has no idea whether the government ratepayer class pays its bills on time because he made no analysis in any of the customer categories of when remittances are received by the Company.

requirements to ensure that ratepayers are not compensating the Company for a return on funds that are in fact supplied by ratepayers *not investors*. Indeed, ComEd's arbitrary midpoint assumption methodology creates the very real possibility that rate base is significantly overstated given the timing of the Company's actual cash flows.

While Mr. Hengtgen encourages the continued adoption by the Commission of this flawed aging interval, midpoint assumption analysis is appropriate because the Commission has approved such a methodology in a past ComEd rate case (ICC Docket No. 10-0467) and in a past Peoples Gas Light & Coke Company/North Shore Gas Company rate case¹⁹, the Commission is not obliged to blindly follow its previous orders. Illinois courts have held that "decisions of the Commission are not *res judicata*." *Commonwealth Edison Company v. Illinois Commerce Comm'n*, 405 Ill.App.3d 389, 937 N.E.2d 685 (Second Dist. 2010), Rehearing Denied, Nov. 16, 2010. The concept of public regulation requires that the Commission have power to deal freely with each situation that comes before it, regardless of how it may have dealt with a similar or even the same situation in a previous proceeding. *ComEd* at 682, citing *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill.2d 509 (1953). A record containing new evidence or argument that implicates a past decision compels reconsideration on the new record and may require a different result. *Id.* The evidence in *this* record of the arbitrary and random assumptions employed by Mr. Hengtgen in calculating the Company's CWC requirements, as well as the fact that this case will provide the template for evaluation of rate base and operating income expense items in formula rate proceedings in the future, demand that the Commission require the Company to be more precise in its calculation of CWC requirements. No less than

¹⁹¹⁹ ComEd Ex. 16.0 at 8.

three witnesses²⁰ concluded that the Company's calculation of the revenue collections lag was arbitrary and results in overstated revenue collection lag day figures.

Other evidence supports adoption of Mr. Brosch's recommendations. ComEd provided in response to AG data request 7.06, copies of randomly selected bills for 50 residential customers in two consecutive months. A review of the actual remittances from these customers showed no significant pattern of past due balances. AG/AARP Ex. 3.0 at 14-15. This sampling of customer bills is attached to Mr. Brosch's Direct testimony as AG/AARP Exhibit 1.8. This limited sample of actual residential customer bills and payment history casts serious doubt upon the credibility of ComEd's asserted residential revenue collection lag.

Problems are also obvious at the other end of the Accounts Receivable aging spectrum where ComEd has applied its mid-point assumptions. Extremely old receivables that have been outstanding more than 90 days are *fully* incorporated within the ComEd lead-lag study approach and contribute heavily to the Company's estimated revenue collection lag. ComEd's calculations fail to acknowledge that a large percentage of its oldest Accounts Receivable balances will ultimately become uncollectible and not be collected at all. Specifically, the Company's oldest tiers of Accounts Receivable contain a higher percentage of individual customer balances that are at high risk of ultimate write-off as uncollectible. However, ComEd's calculation to estimate the revenue collection lag day value wrongly gives no consideration to the heightened risk of uncollectibles among the oldest outstanding customer accounts. *Id.* At 28. This is problematic because there is no cash flow associated with a customer bill that is not paid, so the uncollectible portion of ComEd's oldest receivable balances, which are never satisfied by customer remittances, can have absolutely no impact upon the Company cash flows or CWC

²⁰ The three witnesses are Mr. Brosch, CUB witness Ralph Smith and IIEC witness Michael Gorman.

requirements. *Id.* At 25. This has the effect of increasing the revenue collection lag portion of the CWC calculation, and thereby increasing the Company's proposed CWC amount.

Mr. Brosch revised the Company's revenue collection lag calculations to remove the portion of Accounts Receivable that ComEd's own analysis predicts will become uncollectible. In doing so, Mr. Brosch applied the Company's own uncollectible risk factors, as used on ComEd's books to accrue provisions for uncollectibles expense, to the monthly Accounts Receivables data prior to employing ComEd's aging intervals and mid-point procedures. In his recalculation of the Revenue Collection lag, Mr. Brosch first reviewed procedures and studies performed by ComEd to quantify its uncollectible expenses and estimate the collectability of the accounts receivable portfolio. These procedures are explained in the Company's response to Data Request No. AG 4.25, which is also included within AG/AARP Exhibit 1.7. Mr. Brosch's revised numbers, which remove the portion of Accounts Receivable that ComEd itself predicts will become uncollectible, are provided in AG/AARP Ex. 3.4, attached to Mr. Brosch's Rebuttal testimony. *Id.* At 28. In all other respects, he retained the Company's arbitrary assumptions and methods in the revenue collection lag calculations used to determine the revised overall revenue lag in column (h) of 46.08 days.

Mr. Brosch explained that it is necessary to remove the estimated uncollectible accounts from the Accounts Receivables aging data when estimating the revenue collection lag because, by definition, uncollectible accounts do not yield cash revenues. The Company collects no cash when an individual customer's account balance is written off and removed from the Accounts Receivable balance on the books. In place of these "lost" accounts receivable, ComEd is allowed to include uncollectibles expenses within its overall revenue requirement, so that the

general body of ratepayers replace the revenue foregone by ComEd whenever individual customers do not pay for service. *Id.* At 29.

The Uncollectibles portion of the overall Accounts Receivables balance is significant, with correspondingly significant revenue collection lag impacts. The total 13-month average Accounts Receivable balance used by ComEd to estimate the revenue collection lag totals \$464.8 million.²¹ *Id.*, citing ComEd response to AG 1.26, Attachment 1 (lead lag workpapers) CFRC 0000404. The “Accumulated Provisions for Uncollectible Accounts” that represent the Company’s expectations of Accounts Receivable that will never be collected range from \$72.5 to \$100.5 million – a substantial portion of the total balance. ComEd’s reliance upon an aging analysis of Accounts Receivable balances that have not been reduced for the Company’s own estimates of uncollectibles is clearly unreasonable. *Id.* At 30.

Mr. Brosch testified, however, that even after correcting the revenue correction lag to remove estimated uncollectible accounts, the Company’s revenue collection lag estimate is not reliable for future use by the Commission. He noted that the revised revenue lag day value resulting from the adjustment to remove uncollectible accounts will modestly improve the accuracy of the Company’s study. However, none of the problems and inherent inaccuracies arising from ComEd’s arbitrary mid-point assumptions, the use of only month-end Accounts Receivable balances, and the Company’s assumptions made regarding billing grace periods are remedied by the changes Mr. Brosch made to the revenue collection lag estimate. *Id.* At 28-30.

In order to create a reliable template for future formula rate reconciliations, the Company should be required to conduct statistical samples of actual customer remittances, to determine the

²¹ AG/AARP Ex. 1.0 at 29, citing ComEd response to AG 1.26, Attachment 1 (lead lag workpapers) CFRC 0000404.

average number of days between collection date and the related prior billing date(s).

Alternatively, ComEd should be required to collect and analyze its average *daily* electric service accounts receivables balance, net of the related uncollectibles reserve, to quantify how many days of its sales are “outstanding” within these balances. Mr. Brosch testified that this Accounts Receivables “turnover” calculation relies upon dividing the net average daily balance of Accounts Receivables by annual utility sales revenues and is routinely used in other jurisdictions to quantify the revenue collection lag for energy utilities. Mr. Brosch recommends that ComEd be required to employ either or both of these methods in future lead lag studies to actually measure customer remittance patterns and more accurately quantify the revenue collection lag, before any future CWC amounts are included in rate base. *Id.* At 30-31.

In response to Mr. Brosch’s proposed removal of uncollectible account receivables from the revenue collection lag calculation, ComEd witness Hengtgen argued that these amounts should remain within his aging interval analysis because “ComEd cannot determine with certainty which customer accounts will become uncollectible.” ComEd Ex. 16.0 at 6. He claimed that even if accounts receivable balances become uncollectible, they would have to be considered separately in the CWC calculation in order to determine how long it takes ComEd to recover those amounts and be made whole, “or whether ComEd ever is made whole.” *Id.* He argued that even when ComEd collects its uncollectibles through base rates or through recovery in the uncollectibles rider, “ComEd still is ‘out’ the time value of the amount in question... .” *Id.* Mr. Hengtgen analogizes this alleged loss of funds to a banker recovering only the principal amount of a loan when a borrower defaults. *Id.*

This response misses the mark for a couple of reasons. First, amounts that will not be collected at all (but are recovered through rates and an uncollectibles rider) cannot, by definition,

impact the timing of ComEd's cash flows. AG/AARP Ex. 3.0 at 15. As noted by Mr. Brosch, the Company itself uses detailed risk assessments to determine the uncollectible portion of its overall accounts receivables balances in each aging category used in its CWC assessment that will ultimately prove to be bad debts. It is these estimates that are used by the Company to determine monthly uncollectible amounts that serve as the basis for recorded uncollectible accounts expenses that are reported in the Company's audited financial statements. *Id.* There simply is no cash flow when customers do not pay their utility bills. Some time after estimates of uncollectible amounts are initially recorded by the Company, these amounts are written-off and removed from the Company's Accounts Receivable balance. *Id.* At 15-16.

Second, Mr. Hengtgen's statement that ComEd should not reduce its Accounts Receivables balances for the estimated uncollectibles amounts therein, because it cannot determine "with certainty" which customer accounts will become uncollectible, is a red herring. As noted by Mr. Brosch, if one merely accepts the fact that ComEd's rates recognize a knowable percentage of uncollectibles within the recorded Accounts Receivable balance, it is obvious that fully including uncollectible receivables in Mr. Hengtgen's aging analysis will overstate the delay in cash collections from customers. *Id.* At 17. Again, uncollectibles accounts by definition do not yield *any* cash flow or produce any collection lag and must be excluded whenever Accounts Receivables balances are used to estimate the Company's revenue lag. *Id.*

It is important for the Commission to recognize, too, that ComEd's uncollectibles are, in fact, fully collected from *other* customers who do pay their utility bills. This occurs through the recognition of uncollectibles accounts expenses in the Company's rate case revenue requirement (and will continue in formula rates) and by tracking changes in recorded uncollectibles expenses through ComEd's Rider UF. Mr. Hengtgen, who testified he was not familiar with the details of

how ComEd's Rider UF worked, nevertheless confirmed that that is the case. Tr. At 263-264.

Mr. Hengtgen further acknowledged that when a customer pays a bill, the portion that reimburses ComEd for its test year level of uncollectibles expense does not arrive any slower than the remainder of the remittance. Tr. At 262-263. Moreover, in the future, ComEd formula rate reconciliation procedures will provide another layer of assurance that paying customers will bear the full cost of the Company's uncollectibles. Mr. Hengtgen's stated concern about the Company not being made whole for its uncollectibles expense is nothing more than a strawman argument.

Moreover, Mr. Hengtgen's argument that the Company is out "the time value of money" of uncollectible amounts, notwithstanding the fact that ComEd fully recovers its uncollectible costs through paying customer rates, is another bogus argument. As pointed out by Mr. Brosch, a provision for uncollectibles is recorded each month by ComEd and the resulting uncollectibles expense is included directly within the ratemaking process. Stated another way, the rates that customers pay currently reflect ComEd's own estimate of uncollectible expense on a going forward basis. Thus, there is no lost "time value of money" or loss of interest on a loan (as analogized by Mr. Hengtgen) involved at all, because the allowance for uncollectibles is a recurring accrual-basis entry on the books that immediately recognizes the uncollectible portion of currently recorded revenues. There is no delay in this accounting procedure or in ComEd's ability to continuously recover its estimated uncollectible expense from ratepayers through its rates and Rider UF. *Id.* At 19.

Mr. Hengtgen's only other criticism of Mr. Brosch's removal of uncollectibles balances from the revenue collection lag calculation was his claim that his use of "monthly gross uncollectibles reserve balances before any deductions for deposit reserves and estimated

recoveries” do not reflect the true reserve for uncollectibles on ComEd’s books. ComEd Ex. 16.0 at 6. Mr. Brosch explained why this argument, too, is off-base. Mr. Brosch explained that his calculation used the portion of ComEd’s uncollectibles estimate that is applied by the Company to the Accounts Receivables balances that are used in Mr. Hengtgen’s flawed aging intervals analysis. Mr. Hengtgen’s suggested refinements to account for offsetting customer deposit balances or for subsequent recoveries of amounts written off are considerations in measurement of uncollectibles expenses to be charged to customers. But they do not change the fact that significant portions of the Company’s oldest receivables are not expected to be collected by ComEd, and are improperly used by Mr. Hengtgen to overstate the revenue collection lag. AG/AARP Ex. 3.0 at 20.

In addition, it should be noted Mr. Brosch was not the only intervenor witness who recommended reducing the Company’s CWC Accounts Receivables balances for estimated uncollectibles. CUB witness Smith, a Certified Public Accountant with considerable regulatory experience, likewise believes that the Company must account for the estimated uncollectibles within the Accounts Receivables balance. CUB Ex. 1.0 at 31. As another point of reference, Ameren Illinois Utilities, which recently submitted its formula rate filing, made the specific reduction in its aged Accounts Receivables balance that Mr. Brosch proposes in this ComEd case. As Mr. Brosch testified, in the pending Docket No. 12-0001, the lead-lag study sponsored by Ameren witness David Heintz includes a reduction in the aged accounts receivable balance for estimated uncollectible factors. *Id.* At 23. A copy of Ameren’s workpapers is attached to Mr. Brosch’s Rebuttal testimony provided as AG/AARP Ex. 3.2.

As noted above, while the revised revenue lag day value resulting from the adjustment to remove uncollectible accounts will modestly improve the accuracy of the Company’s study,

none of the problems and inherent inaccuracies arising from ComEd's use of (1) arbitrary mid-point assumptions, (2) only month-end Accounts Receivable balances, and (3) assumptions regarding billing grace periods are remedied by the changes Mr. Brosch made to the revenue collection lag estimate. *Id.* At 30. Mr. Brosch explained that in order to fully correct its estimated revenue collection lag day value, the Company should be required on a going-forward basis to conduct statistical samples of actual customer remittances, to determine the average number of days between collection date and the related prior billing dates.

Alternatively, ComEd should be required to collect and analyze its average *daily* electric service accounts receivables balance, net of the related uncollectibles reserve, to quantify how many days of its sales are "outstanding" within these balances. This Accounts Receivables "turnover" calculation relies upon dividing the net average daily balance of Accounts Receivables by annual utility sales revenues and is routinely used in other jurisdictions to quantify the revenue collection lag for energy utilities. Mr. Brosch recommended that ComEd be required to employ either or both of these methods in future lead-lag studies to actually measure customer remittance patterns and more accurately quantify the revenue collection lag, before any future CWC amounts are included in rate base.

This requirement that the Company be more precise in its quantification of CWC needs is especially important in a formula rate-setting environment, in which the template for rate base and operating expenses quantification is being established. If ratepayers are being asked to provide ComEd compensation for its updated revenue requirement on an annual basis (at least in accordance with its reported expense and capital needs in annual FERC Form 1 filings, as modified by the Commission's ratemaking adjustment authority), the Company must be required

to establish a reasonable framework that promises to accurately measure actual cash working capital needs.

Before allowing any CWC in rate base, it is critical for the Commission to first adopt Mr. Brosch's recommendation to remove the estimated accounts receivables balances that the Company itself believes will become uncollectible from the calculation of the revenue collection lag, and then require the Company on a going-forward basis to conduct statistical samples of actual customer remittances, to determine the average number of days between collection date and the related prior billing dates. Alternatively, ComEd should be required to collect and analyze its average *daily* electric service accounts receivables balance, net of the related uncollectibles reserve, to quantify how many days of its sales are "outstanding" within these balances. These reasonable recommendations should be adopted by the Commission to ensure that customers are not paying more than the Company's actual cost of service, and more specifically, its CWC needs.

b) Pass-Through Taxes

Another modification to ComEd's lead-lag study is needed in order to accurately reflect the Company's CWC requirements associated with pass-through taxes. Without any analysis to support changes in the treatment of cash outlays and inflows associated with these pass-through items, Mr. Hengtgen has inappropriately assigned revenue lag day values for these pass-through amounts, contrary to prior Commission treatment of these expenses in ComEd's last rate case. The effect of the Company-sponsored change is significant. Mr. Hengtgen's inserted collection lag for these items increases the proposed CWC requirement by \$39 million. AG/AARP Ex. 3.0 at 25. Mr. Brosch, and other Staff and intervenor witnesses²², recommend assignment of a zero

²²²² See, e.g. CUB Ex. 1.0 at 16-21; Staff Ex. 3.0 at 8-12.

revenue collection lag to these amounts because ComEd simply serves as the collection agent and no tax (or cash outlay) is owed until after revenues are collected by ComEd. Specifically, Mr. Brosch set to zero the revenue lag days associated with pass-through charges for “Energy Assistance and Renewable Energy Fees” (“EAC/REC”, as well as “Gross Receipts/Municipal Utility Taxes” (“GRT/MUT”).

The reflection of a zero collection lag in the lead-lag study is consistent with the Commission’s prior treatment of this expense item in ComEd’s last rate case. In Docket 10-0467, the Commission found that pass-through taxes should *not* be assigned a revenue lag because they are payable after revenues are collected from customers, noting that both the EAC/REC and GRT/MUT fees and taxes require ComEd to remit these pass-through taxes after they have been collected from customers. *See* ICC Docket No. 10-0467, Order of May 24, 2011 at 48. The adjustments Mr. Brosch proposes have the effect of eliminating the revenue lag day values for these pass-through amounts, as shown at lines 21 and 22 of AG/AARP Ex. 3.4.

Additionally, Mr. Brosch revised the expense lead day value for the Energy Assistance Charge because Illinois law provides that a public utility engaged in the delivery of electricity shall assess each of its customer accounts a monthly charge and shall remit all moneys received as payment to the Illinois Department of Revenue by the 20th day of the month following the month of collection. 305 ILCS 20/13. These terms yield an expense lead days value of 20 days, plus half of the prior month of 15.2 days, for a total expense lead of 35.2 days. AG/AARP Ex. 1.0 at 37.

As Mr. Brosch observed, there have been no changes in the Company’s processes for collecting and remitting pass-through taxes that justify revising the Commission’s treatment of these cash flows in determining CWC. *Id.* at 37. In fact, Mr. Hengtgen conceded that the

EAC/REC and GRT/MUT amounts are due to the taxing authorities only after revenues have been collected by ComEd. ComEd Ex. 16.0 at 14. He justifies the revenue collection lag amounts by stating that ComEd has elected to pay these pass-through items earlier than is required.

This position is untenable, however. ComEd is reasonably expected to pay its taxes when due, so as to minimize the amount of CWC required to operate its business. It should be noted, too, that the Public Utilities Act requires that utility service rates be “least cost”²³, and that rates be just and reasonable. *See* 220 ILCS 5/1-102, 102(a), 8-401; 9-201. Requiring ratepayers to pay higher rates so that ComEd can choose to pay its bills early is neither reasonable nor consistent with the General Assembly’s least cost mandate. Mr. Brosch noted, too, that utilities routinely use mechanized payments or wire transfers to optimize their cash flow management, just as ratepayers utilize automatic deposit and debit opportunities to optimize their finances. ComEd has provided no evidence that its early payment of these pass-through expenses are necessary or prudent. Mr. Brosch’s adjustment should be adopted, as reflected in AG/AARP Ex. 3.4, lines 21 and 22.

c) Intercompany Billing Lead

In Docket No. 10-0467, the Commission Staff proposed modification of the payment lead days applied to affiliate transactions, out of concern that unreasonably expedited payments to

²³ The Act makes multiple references to the mandate that utility rates be least-cost. Section 1-102 of the Act states that “the General Assembly finds that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens.” 220 ILCS 51-102. The General Assembly further defined “efficiency” as “the provision of reliable energy services at the least possible cost to the citizens of the State”. 220 ILCS 5/1-102(a). Section 8-401 requires every public utility subject to the Act to provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility’s service obligations. 220 ILCS 5/8-401.

affiliates could create an unreasonable cross-subsidy. In the Commission's Final Order in that docket, the Commission adopted Staff's proposed expense lead days, based on Company information that showed that payment to affiliates was not required until after the provision of service. Like its proposed treatment of pass-through taxes discussed above, ComEd has supplied no evidence in this case that ratepayers should pay an unnecessarily increased level for the Company's CWC because the Company chooses to pay its affiliate vendors unnecessarily early, as compared to other vendors.

In order to reflect the Company's *true* CWC requirements, AG/AARP witness Brosch proposed that the expense lead day values assigned to InterCompany Billings from Exelon Business Services Company ("BSC") be increased from the 30.55 days used by ComEd to 45.35 days. This adjustment can be found in AG/AARP Ex. 3.4, lines 4 and 5, columns (d) and (j) respectively. As a point of reference, the Company's lead-lag study concludes that vendors who are not affiliated with ComEd experience a payment lead of 66.82 days (which is applied to "Other O&M Expense" at line 7 of AG/AARP Ex. 3.4). It simply is not reasonable to apply more expedited payments to ComEd affiliates, compared to the timing of payments to ComEd's other vendors, without some showing by ComEd that the Company is either required to pay early or is otherwise compensated by its affiliates for doing so. AG/AARP Ex. 1.0 at 34-35.

In addition to increasing the expense lead day value for this category of expenses, Mr. Brosch urged the Commission to order ComEd to perform a study similar to a lead-lag study in order to quantify the CWC requirement associated with ComEd's Exelon Business Service Company ("BSC"), rather than simply adopting the Company's policy of payments to BSC by the 15th of the following month. AG/AARP Ex. 1.0 at 35. He noted that it is inappropriate for the Commission to simply approve ComEd's "internal policy" of paying its BSC affiliate by the

15th of the following month services are provided, with no showing that such a payment policy is reasonable or consistent with the CWC needs of BSC. A more reasonable assumption would be utilization of the Company's lead lag study value for vendors that are not affiliated with ComEd and that experience a payment lead of 66.82 days, which is applied to ComEd's "Other O&M Expense." Until then, Mr. Brosch's proposed revision to the ComEd lead-lag study adopts a conservative 45.35 lead value for intercompany payments – the same value that was recently approved by the Commission in ComEd's last rate case.

d) Employee Benefits – Pension and OPEB Expenses

Another defect in the ComEd CWC lead-lag study can be found in Mr. Hengtgen's treatment of Pension and OPEB expenses, which applies unsubstantiated assumptions about disbursement of and recovery of these expenses. Specifically, the Hengtgen lead-lag study applies a zero expense payment lead for Pension and OPEB expenses, but the full 51.25 revenue lag to this element of annual CWC needs. This is reflected in column © of line 2 of ComEd Ex. 25.1 and can be more clearly observed at AG/AARP Ex. 3.4, line 2. As noted by Mr. Brosch, Mr. Hengtgen has neither performed nor presented any study or evidence of any kind that a dispersal of funds occurs immediately upon accrual basis recording of the expense, thereby justifying the zero expense payment lead, or that a revenue *collection* lag day value for the cash inflows representing recovery of these expenses occurs. This has the effect of increasing the Company's asserted CWC requirement by a significant \$15.8 million, as shown in column (g) of that exhibit. AG/AARP Ex. 1.0 at 32.

As Mr. Brosch explained, this treatment of Employee Benefits expense is inappropriate because both Pension and OPEB are accrual basis expenses; in other words, these are expenses that are accumulated over time and are derived from actuarial studies. Neither ComEd nor Mr.

Hengtgen analyzed any periodic cash flows to determine CWC impacts. The Company cannot reasonably claim, without evidence, that cash disbursements are made immediately (as reflected in ComEd's zero payment lead) and also claim that revenue recovery is delayed (as reflected in a 51.25 revenue lag day value).

ComEd confirmed in a response to AG data request 1.27 that neither ComEd nor Mr. Hengtgen conducted any measurement of the cash flows associated with these employee benefit expense items, and that "no other analyses, workpapers, projections or correspondence exist supportive of the zero (payment) lead days."²⁴ In the absence of any analysis of the timing of Pension and OPEB cash outflows, there is no basis for blindly applying a 51.25 revenue lag day value for the related cash inflows (revenues) associated with these expenses while simply assuming a zero cash outflow lag value. *Id.* At 33. Because of these unsubstantiated assumptions about employee benefit cash outflows and inflows, Mr. Brosch proposed that the non-cash Pension and OPEB accrued expense amounts be removed from the "Receipts" to which a revenue lag is applied by ComEd. *See* AG/AARP Ex. 3.4, at line 2, columns (h) through (l). CUB witness Smith proposed a similar adjustment. CUB Ex. 1.0 at 30.

In response to Mr. Brosch's proposed adjustment, Mr. Hengtgen argues that no separate study of the cash outflows is necessary or required. He states that the accrued expense amounts for both Pensions and OPEB and the routine, periodic cash payments to the cash outflows for both Pension and OPEB funding are not ignored, as Mr. Brosch avers, but are fully accounted for at 100% in separate rate base line items in this docket. ComEd Ex. 16.0 at 25. He argues that reducing rate base for the Pension and OPEB accruals is the equivalent of including those expense accruals in the lead-lag study and assigning them a 365-day lead. *Id.* At 25-26. The Company argues, too, that because the Commission allowed the Company to include its Pension

²⁴²⁴ A copy of ComEd's response to AG 1.27 is attached to Mr. Brosch's Direct testimony as AG/AARP Ex. 1.9.

and OPEB accruals in the last rate case, Docket No. 10-0467, similar treatment should be permitted here. *Id.* At 26.

Once again, however, Mr. Hengtgen's response is simply incorrect. Both Pensions and OPEB expenses are accrual basis expenses that are derived from actuarial studies and for which cash is periodically disbursed to fund such benefits. However, neither the Company nor Mr. Hengtgen has analyzed any cash flows associated with these cash outflows to determine CWC impacts. Instead, ComEd unreasonably attributes a revenue lag for the delay in cash recovery of these expenses, but then simply pretends that cash has been disbursed immediately to employees when recording accrued Pension and OPEB expenses on its books. There simply is no evidence that such immediate disbursements to fund these benefits have occurred. Quite simply, the Company and Mr. Hengtgen failed to provide such evidence, and thus failed to sustain the burden of proving the reasonableness of such an unorthodox assumption.

Mr. Hengtgen's claim that the fact that ComEd includes its Pension and OPEB amounts in the calculation of rate base negates the need to include a payment lead time for these amounts in the CWC lead-lag study, hence justifying the zero payment value, is equally irrelevant. As noted by Mr. Brosch, if Pension and OPEB transactions are recognized elsewhere in rate base, they should be completely omitted from the lead-lag study. If one concludes that the separate inclusion of Pension asset and OPEB liability balances within rate base makes it unnecessary to include a payment lead value for these transactions, it is equally inappropriate to apply a revenue lag value to these transactions. AG/AARP Ex. 1.0 at 34.

Mr. Brosch's recommended removal of the \$112,785 amount for these expenses that appears at line 11 of ComEd Ex. 16.6 should also be subtracted from the "Total Revenue and Non-Revenue Receipts" at line 7 to eliminate the overstatement of CWC for this non-cash

expense item. This restatement is more clearly observable at line 2 of AG/AARP Ex. 3.4, attached to Mr. Brosch's Rebuttal testimony, where the impact of ComEd's proposal appears in columns (b) through (g), alongside the correction that is recommended by Mr. Brosch in columns (h) through (l). Mr. Brosch's proposed removal of the non-cash Pension and OPEB accrued expense amounts from the "Receipts" to which a revenue lag is applied by ComEd should be adopted by the Commission. *See* AG/AARP Ex. 3.4, at line 2, columns (h) through (l).

e) Accounts Payable Related to CWIP

Another necessary correction to the Hengtgen/ComEd lead-lag study relates to CWC calculations associated with "Accounts Payable Related to CWIP". Specifically, ComEd applied its expense lead days applicable to "Other O&M expense" (from line 17 of ComEd Ex. 8.1, 16.6 and 25.1) to an Accounts Payable balance associated with CWIP (at line 39 of those exhibits). Mr. Brosch testified that this is a meaningless calculation. He explained that for all other elements of the CWC calculation, revenue lag and expense day values/factors are applied to annual expenses or to annual pass-through tax amounts. Application of an "Other O&M Expense" lead day value to an Accounts Payable balance tells us nothing about the timing of ComEd payments related to CWIP transactions, because lag days are not applicable to Accounts Payable balances. AG/AARP Ex. 1.0 at 37. The only explanation offered by Mr. Hengtgen for his approach is that the Order in ComEd's last rate case, Docket No. 10-0467, required that CWIP related accounts payable be included in the CWC calculations and that he believes such payables represent only a temporary source of financing, i.e., working capital, and not a permanent source of financing. ComEd Ex. 16.0 at 28.

Mr. Brosch recommended that because the Company quantified an Accounts Payable balance believed to be associated with CWIP included in rate base, this balance should be

directly included in the CWC calculation. He noted that this balance is the best indicator of how much of the Company's CWIP balance has not been funded in cash, but rather is being funded by ComEd vendors. A more detailed analysis of the timing of cash flows associated with construction/CWIP transactions could be undertaken, but in the absence of such an analysis, directly offsetting the Accounts Payable balance should accomplish a reasonable quantification of vendor-supplied CWC for CWIP transactions. AG/AARP Ex. 1.0 at 38. CUB witness Mr. Smith recommended the same approach. CUB Ex. 1.0 at 31.

Mr. Hengtgen objected to Mr. Brosch's proposed adjustment for CWIP- related accounts payable balances, arguing that use of the entire accounts payable related to CWIP as an indication of vendor supplied financing is unreasonable because "the amount of accounts payable at any given time only exists for a short period of time until the vendor is paid and the vendor supplied financing is converted to investor supplied financing." ComEd Ex. 16.0 at 27. This argument misses the mark, however. In his Rebuttal testimony, Mr. Brosch explained that he understands ComEd is *not* requesting CWIP treatment for only the specific construction projects that existed at year end 2010. Indeed, if that was the Company's proposal, then the entire amount of CWIP at year-end would be redundant to the Company's projected Plant in Service additions that are separately being added into rate base. Instead, the Company is requesting a general allowance for short term CWIP that tends to exist on an ongoing, month-to-month basis, as detailed in ComEd Ex. 12.0 at 18. Under this scenario, it is improper to ignore, as recommended by Mr. Hengtgen, the accounts payable recurring balances each month that represent perpetual short-term, vendor financing for such CWIP. Indeed, all accounts payable balances tend to be transitory until the vendor is paid, only to be replaced by new payables associated with newly rendered invoices. The best indication of how much vendor-supplied

financing is available to fund non-AFUDC CWIP in rate base is the full balance of such payables. AG/AARP Ex. 3.0 at 27. Mr. Brosch's reasonable adjustment to reflect the Company's accounts payable associated with CWIP, as set forth in AG/AARP Ex. 3.4 column (l) at line 26, should be adopted.

f) 401(k) Match

ComEd has included a deferred tax debit balance related to its 401(k) employee benefit match. ComEd Ex. 13.0 at 9. This item is a component of what Mr. Effron described in his Direct testimony as the ADIT related to the Reserve for Employee Litigation. In his Rebuttal testimony, ComEd witness Martin Fruehe testified that a 401(k) match tax deduction has not been recognized at year-end and thus the related ADIT debit balance should be included in rate base. *Id.*

AG/AARP witness Effron pointed out, however, that if the balance of ADIT is included in rate base, then the funds provided by the accrual for the 401(k) match should also be recognized in the calculation of the delivery services rate base – more specifically in the Company's CWC calculation. In response to AG data request 9.03, the Company described a lag in payment of the 401(k) match that is the same as the lag in payment for incentive pay. ComEd included incentive pay expense in its CWC calculation with a 228.50-day lead in payment. The same treatment must be applied to the 401(k) match to ensure that ratepayers are not, again, over-compensating the Company for CWC.

The effect is to reduce the Company's CWC calculation requirement by \$2,718,000, an amount that is incorporated into Mr. Brosch's restatement of ComEd's CWC presentation, and presented in AG/AARP Ex. 3.4, at line 1c. If this adjustment is not made to ComEd's CWC, Mr.

Effron noted, then the \$1,847,000 of ADIT related to the “Company Match 401k Plan” on ComEd Ex. 13.02-WP4-ADIT REV, Page 1 should be removed from the Company’s rate base.

g) Impact of Current and Deferred Taxes

There is no dispute between AG/AARP and ComEd related to the treatment of the current and deferred taxes in the CWC calculation.

h) ComEd Proposal Regarding Timing of Future Lead-lag Study

ComEd witness Kathryn Houtsma complains that a lead-lag study is “time intensive” and she suggests that under formula regulation of the Company, an updated study of the lead-lag days should be performed by ComEd only once every three years. ComEd Ex. 2.0 at 17.

While the People and AARP recognize that the formula rate process expedites, to the extent provided under Section 16-108.5 of the Act, the regulatory review process, such a triennial review of CWC would only be appropriate *after* the problems identified by AG/AARP and other Staff and intervenor witnesses have been rectified. One solution to this problem of complexity, given the controversy surrounding ComEd’s CWC methodologies and the widely divergent estimates of CWC proposed by AG/AARP, CUB and Staff in comparison to ComEd, would be to not allow any CWC in rate base under formula regulation. Alternatively, the more intensive analysis recommended by Mr. Brosch to improve the analysis and reliability of the revenue lag component of the CWC presentation must first be conducted to ensure that inaccurate lag day numbers are not “frozen” for re-use in multiple annual formula rate adjustment filings, and that ratepayers are not over-compensating ComEd for its stated CWC needs.

5. Accumulated Deferred Income Taxes

In ComEd's last rate case, the Commission addressed issues associated with accumulated deferred income taxes (ADIT). The Commission stated that "it is not controverted that, if accumulated depreciation must match *pro forma* plant additions, ADIT must also correspond in this manner." ICC Docket 10-0467, Order at 24 (May 24, 2011). ADIT represents the accumulation of tax savings resulting from income tax deductions, such as those associated with plant investment. These non-investor supplied funds are then available for use by ComEd. Because these funds are not provided by shareholders or investors, the Company is not allowed to earn a return on them. Otherwise, rates would be increased to pay for a profit on zero-cost capital. *Id.* at 22-23. In Docket 10-0467, the Commission reduced rate base by \$1.8 billion to reflect the ADIT effect of various tax savings. *Id.* at 22 & App. A, page 6.

In this formula rate docket, it is important to recognize the effect of ADIT both in the inception revenue requirement and in the reconciliation revenue requirement. When ComEd reconciles the revenue requirement for 2011 in this case to the actual 2011 revenue requirement in its 2012 filing under the reconciliation procedure, the rate base used in the actual revenue requirement calculation will reflect the actual balances of accumulated deferred income taxes in 2011. However, when there is a large tax deduction that will have a material effect on the revenue requirement, and it can be accurately measured and incorporated into the inception revenue requirement, the difference between the inception revenue requirement and the reconciliation revenue requirement can be minimized, creating more rate stability for consumers and a more accurate revenue stream for ComEd.

a) 2011 Plant Additions

ComEd has included \$648,431,000 in projected plant additions for 2011 in its pro forma rate base and has recognized an associated increase in the balance of accumulated depreciation of

\$363,584,000. The net effect is to increase rate base by \$320,847,000. AG/AARP Ex. 2.0 at 13. ComEd has not adjusted rate base to remove \$265,681,000 in ADIT associated with 2011 bonus depreciation. *Id.* at 14, 16. This adjustment is necessary both to remove non-investor funds from rate base and to produce an inception revenue requirement that is reasonably close to what the reconciliation revenue requirement can be expected to be.

AG/AARP witness Effron testified that there is no question that when the actual revenue requirement is determined in the reconciliation, ADIT balances will be accurately reflected. AG/AARP Ex. 2.0 at 14. Nevertheless, there would be little purpose to proposing an adjustment to increase ADIT (i.e. decrease rate base) if the only effect would be to increase the difference between the revenue requirement set in this docket and the reconciliation revenue requirement. However, in this year due to bonus depreciation (which allows deduction of 100% of plant investment), the magnitude of the tax deduction, and the funds available as non-investor supplied capital, is so great that it would distort the revenue requirement to ignore it. *Id.* Further, bonus depreciation continues into 2012 (at the rate of 50%), which will further offset the need for investor capital. Mr. Effron concluded that “[i]n the circumstances of this case, I believe that this adjustment would tend to reduce, rather than to increase, any discrepancy between the test year rate base in this case and the actual [or reconciliation] 2012 rate base.” *Id.* at 16.

ComEd admits that including an estimated amount of ADIT related to the 2011 projected plant additions will ultimately result in a rate base calculation that, all else held equal, will be closer to the 2011 actual rate base. ComEd Ex. 13.0 p. 6. ComEd argues, however, as there are dozens of line items that comprise the calculation of jurisdictional ADIT, updating the calculation on one such item does not make sense. ComEd’s argument misses the key fact that the magnitude of the tax deduction related to the 2011 plant additions sets it apart from the rest

of the ADIT line items. ComEd does not dispute the increase to ADIT of \$265,681,000 related to the bonus depreciation and does not cite any other items of ADIT of a similar magnitude.

AG/AARP Ex. 4.0 at 9. Indeed, ComEd witness Fruehe agrees with AG/AARP witness Effron that the 2011 plant additions will be the most significant change to ADIT. ComEd Ex. 22.0 p. 6.

It should also be noted that the ADIT on the 2011 plant additions is not the only large increase to ADIT that ComEd is proposing to ignore. For instance, ComEd intends to modify its accounting for the repair deduction and will include a Section 481(a) (“catch-up”) adjustment as a result of this modification. Such an adjustment would have the effect of increasing the ADIT by about \$240 million. ComEd does not incorporate this amount into its rate base determination. Given that the rate base is not being adjusted to recognize this increase in ADIT, it would be inappropriate to compound the discrepancy by ignoring the increase in ADIT related to the bonus depreciation on 2011 plant additions. Accordingly, the rate base deduction for ADIT should be increased by \$265,681,000 to recognize the deferred taxes for the bonus depreciation on the 2011 plant additions.

b) Bad Debt Reserve

The timing of tax deductions for uncollectible accounts expenses, or bad debt expenses, for book purposes differs from the timing of those expenses for income tax purposes. In the case of ComEd, the cumulative income tax deductions for bad debt expenses have been less than the book expenses. The balance of the ADIT for bad debt expenses results from these lower income tax deductions.

Less than 100% of bad debt expense is allocated to the jurisdictional revenue requirement. The ADIT for bad debt expenses are directly derived from the bad debt expenses themselves. Therefore, it is logical that if less than 100% of the bad debt expense is allocated to

delivery services, then the ADIT that is directly derived from that expense should also be allocated at less than 100% to the jurisdictional delivery services rate base. ComEd, however, assigns 100% of the debit balance of this ADIT to the jurisdictional delivery services rate base.

Based on the allocation of bad debt expense of 34.87% to the delivery services jurisdiction, AG Witness Efron recommends that the ADIT for bad debt expenses be allocated at the same percentage. This allocation results in \$10,408,000 of the ADIT for bad debt expense being allocated to the delivery services rate base, \$19,440,000 less than the balance allocated by ComEd.

ComEd witness Fruehe resists this argument by stating that AG/AARP witness Efron's position on ADIT for bad debt expense is in contrast to the position that AG witness Michael Brosch took in ICC Docket No. 10-0467. In that docket, AG witness Brosch argued that if ComEd could not show how the late payment charges were reflected in other jurisdictions (*e.g.* transmission or supply related charges), the balance had to be assigned to delivery services. AG/AARP Efron's position on ADIT for bad debt expense in the present docket is not inconsistent with this position on late payment charges because the relationship between bad debt expenses and late payment charges is not the same as the relationship between bad debt expenses and the ADIT that is directly derived from the bad debt expenses. In fact, late payment charges relate to debt that in fact is paid, albeit late. By contrast, bad debt expenses are accounts that are not paid and become uncollectible.

There is no dispute that less than 100% of the bad debt expense is allocated to the jurisdictional revenue requirement. AG witness Efron's argument is simply that the ADIT for bad debt expenses be treated the same way that bad debt expenses are treated because the ADIT on bad debt is directly derived from the bad debt expense itself. The People's proposal that

ADIT for bad debt expenses be treated the same way that bad debt expenses are treated is the most logical way of addressing this particular ADIT item and should be adopted.

c) and d) Vacation Pay and Incentive Pay

Vacation pay and incentive pay are only deductible for income taxes as paid. Thus, to the extent that the accruals take place in advance of payment, there is a book-tax timing difference. ComEd records deferred taxes to recognize this, and the result is a deferred tax debit balance that offsets the accrued reserve balances. As the People argue below in the Operating Reserves section, the liabilities giving rise to those deferred taxes should be included in the operating reserves deducted from the rate base. The corresponding ADIT balances should be synchronized with vacation pay and incentive pay included in operating reserves so that those ADIT balances are stated on a basis that is consistent with the operating reserves deducted from the rate base. As shown in Schedule DJE-1.2R, the ADIT balances consistent with the accrued vacation pay and incentive pay included in operating reserves should be \$17,553,000 and \$11,412,000 respectively.

e) FIN47

6. Operating Reserves

Operating reserves are funds accrued in excess of cash actually paid out, or disbursed in payment of certain expenses. Similar to ADIT, these reserves provide ComEd with a non-investor source of funds. Most of the operating reserves that are deducted from rate base as non-investor funds relate to accruals for future claims and employee compensation and benefits that have been accrued as earned, but have not yet been paid. There is a substantial lag between the time that these expenses are recognized and the time that the cash is disbursed to pay the

expenses. It is this lag that creates a non-investor source of funds that is deducted from the utility rate base as “operating reserves.”

a) Accrued Vacation Pay

ComEd’s responses to data requests showed that there is a substantial lag in payment between the time that vacation pay accrues and when it is actually paid. AG/AARP Ex. 1.0 at 9. This substantial lag in the payment of accrued vacation is not reflected in the Company’s cash working capital calculation, so it must be treated separately. The credit balance of Accrued Vacation remains stable enough for ComEd to carry forward the balance from December of one year through November of the next because as employees use vacation pay, they have also earned new vacation pay, replenishing the reserve. ComEd, however, does not properly take into account the long time it holds these funds and maintains a credit balance for Accrued Vacation in either its cash working capital analysis or in its operating reserves.

The vacation pay is, in effect, disbursed in the year following the year in which the liability is accrued, as the employees use their vacation time but more vacation time is accrued. This lag in disbursement is well in excess of the lag in payment of regular employee salaries and wages, and this lag should be recognized as creating a non-investor source of funds that should be deducted from the rate base.

ComEd witness Fruehe states that the accrued vacation reserve is short term in nature and that is why it should not be deducted from the rate base. ComEd Ex. 22.0 p. 3. But as seen in AG Cross Ex. 1, the credit balance does not disappear but is maintained as a relatively stable balance. Therefore the accrued vacation pay should be deducted from the rate base.

As stated above, the reserve for accrued vacation over the course of 2010 was \$49,500,000. The jurisdictional amount of this balance is \$44,164,000. AG/AARP Ex. 2.0 p. 10.

Of this amount, \$823,000 was recognized in the cash working capital allowance. The excess, or \$43,341,000, should be added to the operating reserves that are deducted from rate base, and ComEd's rate base should be reduced accordingly.

In addition, vacation pay and incentive pay are only deductible for income taxes as paid. Thus, to the extent that the accruals take place in advance of payment, there is a book-tax timing difference. ComEd records deferred taxes to recognize this, and this results in deferred tax debit balances that offset the accrued reserve balances. If the deferred tax debit balances are included in the rate base, then the accrued liabilities giving rise to those deferred taxes should be included in the operating reserves deducted from rate base. The ADIT related to the lag in paying accrued vacation time included in the rate base should be modified so that it is consistent with the balance that is deducted from the rate base.

b) Accrued Incentive Pay

For the same reasons stated above regarding accrued vacation pay, accrued incentive compensation pay should also be credited against rate base as ratepayer funds held in operating reserves. In its rebuttal testimony, ComEd modified its calculation of cash working capital to recognize a longer lead in payment of incentive pay expense as AG/AARP witness Effron urged. This modification reduced its cash working capital requirement. The People and AARP believe, however, that an additional modification to ComEd's treatment of accrued incentive pay is appropriate and that the accrued liability for the capitalized portion of incentive pay should be included in the operating reserves that are deducted from rate base.

ComEd recognizes the accrued liability for the expense portion of incentive pay in the calculation of its cash working capital requirement, but this does not address the portion of incentive pay that is not charged directly to operation and maintenance expenses. The portion of

incentive compensation related to work on capital projects is capitalized and charged to plant accounts. This accrued liability related to the capitalized portion of incentive compensation should be deducted from rate base. This reduces ComEd's delivery service rate base by \$10,562,000 (Schedule DJE-1.2R).

ComEd argues, however, that the incentive compensation related to capital investments is first recorded as construction work in progress ("CWIP") of which only a very small portion is included in ComEd rate base and as such, "ComEd does not earn a return on the capitalized amount [of incentive compensation pay] and the accrued liability related to the capital portion should not be deducted from the rate base nor should the corresponding ADIT balance be reduced." ComEd Ex. 22.0 p. 12. This is inaccurate.

When utilities are in the process of building a plant, the investment is not included in the rate base because the plant is not yet providing service. Capital investments are first recorded as construction work in progress ("CWIP"). But to finance the cost of the construction, utilities accrue allowance of funds used during construction ("AFUDC") income, and that is added to the cost of the plant. When the plant goes into service, the utility will earn a return on the plant, including the AFUDC. Indeed, ComEd witness Fruehe later admitted that ComEd does accrue AFUDC on CWIP that is not included in rate base and that AFUDC does provide ComEd with a return on that CWIP. Therefore, ComEd's argument for not deducting the capitalized amount from rate base should be rejected. Rate base should be reduced by \$10,562,000 to include capitalized incentive pay in operating reserves. AG/AARP Ex. 4.0 at 7-8 & Sch. DJE-1R.

7. Other

IV. REVENUES

- A. Potentially Uncontested Issues**
- B. Potentially Contested Issues**

1. Late Payment Charges Revenues Allocation

When consumers are late in paying their bills, Commission rules and ComEd tariffs allow the Company to assess a late payment charge. These revenues are shown in Account 450, Late Payment Fees (called forfeited discounts in the FERC accounts) and totaled \$36.1 million in 2010. AG/AARP Ex. 1.0 at 45. ComEd attributed about \$2.6 million to the FERC jurisdiction, attributing about 93% of these revenues to the Illinois jurisdiction. *Id.*

In the last ComEd rate order, Docket 10-0467, the Commission approved an AG adjustment assigning all late payment charge revenues to the Illinois jurisdiction except those explicitly assigned to the FERC jurisdiction, and rejected ComEd's proposal to withhold \$13.9 million from Illinois revenues. The Commission held that only a small portion of these revenues, *i.e.* \$2 million, were properly allocated to the FERC jurisdiction. Docket 10-0467, Order at 305-306 (May 24, 2011).

ComEd's treatment of late payment revenues in its formula filing is consistent with the Docket 10-0467 Order and the People's position in that case. The People support ComEd's treatment of Late Payment Charges in its filing in this case because it continues to use the jurisdictional allocations approved in Docket 10-0467. However, should the Commission accept ComEd's request to change other existing allocation methods, the People request that the Commission also modify the Late Payment Fees allocation to include 100% of those revenues in distribution revenues. Although ComEd assigns about 7% of its late payment charge revenues to transmission (FERC) jurisdiction, ComEd was not able to cite any specific FERC Order or other authority justifying this allocation. AG/AARP Ex. 1.0 at 45; AG/AARP Ex. 1.10, page 20, Bates Number 0007349.

ComEd's tariffs assess its distribution customers the late payment charge as a percentage of the outstanding balance on the bill, irrespective of whether the outstanding balance is supply, delivery, or any other type of charge.²⁵ ComEd customers pay these charges and should be credited the revenues from them in calculating ComEd's revenue requirement. As a delivery company, ComEd bills for functions other than delivery, and assesses late charges on any unpaid balance on a bill, irrespective of whether the underlying charge is for delivery, supply, transmission or other service. In the absence of specific authority for shifting this revenue to the FERC jurisdiction, and if the Commission accepts ComEd's proposed changes in jurisdictional allocations discussed elsewhere in this Initial Brief, the Commission should credit Illinois customers with 100% of the late payment charge revenues, resulting in a \$2,647,000 increase in jurisdictional revenues. See AG/AARP Ex. 1.3, Fn. 2.

2. New Business and Billing Determinants

The formula tariff authorizes ComEd to add projected plant additions to its historical rate base, in this case adding \$684,431,000 in 2011 projected plant additions to its 2010 historical rate base. Net of associated depreciation, projected plant additions for 2011 increase rate base by \$320,847,000. AG/AARP Ex. 2.0 Rev. at 13. Of this increase, approximately \$127.1 million represents facilities to accommodate customer growth. *Id.* at 16.

Section 16-108.5(c)(1) provides that the formula rate tariff provide for the utility's actual costs of delivery services "consistent with Commission practice and law." The Commission has historically made an adjustment to ComEd's revenues to reflect the change in revenues expected from plant additions that serve customer growth. See, e.g., Docket 10-0467, Order at 306-309

²⁵ Commonwealth Edison Co., Ill.C.C. No. 10, 1st Rev. Sheet No. 207.

(May 24, 2011); Docket 07-0566, Order (September 10, 2008). A similar adjustment to revenues is necessary in this docket to be consistent with Commission practice and law.

Rather than quantify a revenue adjustment, in this docket an adjustment to the 2010 billing determinants that will be used to allocate the revenue requirement among customers is necessary. See ComEd Ex. 9.0, 5-8. New plant will serve an increase in the number of customers served by ComEd requiring a 0.42% increase in the number of residential customers and a 0.90% increase in the number of small commercial and industrial (SCI) customers by 0.90%. AG/AARP Exhibit 2.2. ComEd should be directed to make this change to the billing determinants so that the revenue requirement established in this docket is collected from the appropriate number of customers. If the billing determinants do not match the number of customers served by plant additions and customer growth in 2011, the revenue requirement will be collected from too few customers, the rate per customer will be higher than it should be, and ComEd will collect more than its actual costs and revenue requirement.

ComEd argues that Section 16-108.5(c)(4)(H) reverses Commission practice, accepted by ComEd in past rate cases, to use billing determinants that correctly incorporate customer growth. See Docket 10-0467, Order at 306.²⁶ That section simply states that the formula shall:

- (4) Permit and set forth protocols, subject to a determination of prudence and reasonableness consistent with Commission practice and law, for the following:
- (H) historical weather normalized billing determinants;

Contrary to ComEd witness Fruehe's argument, this language does not lock the formula into using inaccurate and under-stated billing determinants that ignore real customer growth resulting from plant additions. If "historical" were used in that sense, the formula would be designed to over-collect ComEd's revenue requirement because real customer growth would be ignored.

²⁶ In that Order the Commission noted: "As it has done in its last two rate cases (Docket Nos. 05-0579 and 07-0566), ComEd has included a new business revenue credit to account for the estimated revenue from growth in customers during the *pro forma* period."

Further, the billing determinant used in this docket will be the basis for collection of the 2011 revenue requirement and will persist into the reconciliation when the actual costs for 2011 will be reconciled with the 2010 FERC Form 1 costs. The reconciliation does not adjust for the actual 2011 billing determinants – it uses the same billing determinants used to set 2011 rates irrespective of actual sales. The only way to capture the customer growth associated with the new business (or customer growth) resulting from 2011 plant additions is to adjust the billing determinants in the inception case. If understated billing determinants are used, ComEd will consistently over-recover its revenue requirement, which is not the result expected by ComEd witness Ross Hemphill when he stated that “the annual reconciliation proceedings ensure that ComEd recovers no more than its actual costs of service.” ComEd Ex. 1.0 at 19.

While arguing that Section 16-108.5 requires the use of “historical billing determinants,” ComEd witness Fruehe fails to clearly identify what “historical” period he is referring to. In fact, using this docket as a model, the formula establishes a *2011* revenue requirement to be collected in *2012*, based on *2010* data including *2011* plant additions. The 2010 historical billing determinants, adjusted to reflect customer growth resulting from those same 2011 plant additions, are still historical billing determinants – for 2010, adjusted for 2011 growth, “consistent with Commission practice and law.” While Mr. Fruehe argued (in a somewhat different context addressed below) that AG/AARP witness Effron “ignores the bigger picture of what change would be expected if total billing determinants were updated ,” ComEd witnesses ignore that if the formula consistently under-states billing determinants by excluding “new business” customer growth, the formula will consistently allow ComEd to spread its revenue requirement over a customer base that is smaller than it actually is – raising prices for all

customers. The argument that this adjustment should be ignored because the adjustment for 2011 plant additions is not “historical” should be rejected.

AG/AARP witness Effron recommended that the adjustment be limited to *customer* growth related to plant additions. He did not include the change in kwh usage despite the fact that in past cases the Company and the Commission have recognized growth in both the number of customers and kwh’s because ComEd showed a decline in weather normalized sales. AG/AARP Ex. 1.0 at 17. He did not decrease total kwh’s because plant additions for customer growth, by definition, only result in growth – otherwise the investments would not be made. It would be irrational to invest in new plant for customer growth while assuming that these new customers did not take service. However, in light of the overall decline in total kwh sales (which Mr. Effron pointed out was anomalous), Mr. Effron did not recommend that kwh sales billing determinants be increased. Contrary to ComEd witness Fruehe’s charge that Mr. Effron “ignores the bigger picture” by limiting his adjustment to customer growth, he recognizes the “bigger picture” of decreased kwh sales in ComEd’s 2010 billing determinants.

The new business adjustment related to plant additions should be part of the formula rate calculation. It does not violate the statutory provision to use “historical billing determinants,” and is necessary to accurately match the plant additions investment with customer growth, to be consistent with prior Commission practice, and to assure that ComEd “recovers no more than its actual costs of service.” ComEd Ex. 1.0 at 19.

3. Other

V. OPERATING EXPENSES

A. Overview

B. Potentially Uncontested Issues

1. Distribution

2. Customer Accounts Expenses Other Than Uncollectibles, Including Staff Proposal re Interest on Customer Deposits (see also III.B.5)

3. **Uncollectibles Expense and Staff Rider Proposal**
4. **Customer Service and Informational Expenses**
5. **Adjustments for Ratemaking, Other Tariffs, Past Orders, and Other**
6. **Administrative and General Expenses**
 - a) **Regulatory Commission Expense**
 - b) **Customer Deposits (see also III.B.4)**
 - c) **Transmission-Related Research and Development**
 - d) **Sporting Event Activities**
 - e) **Outside Services**
 - f) **Correction of Error Relating to Rider EDA**
 - g) **Photovoltaic Pilot Costs**
7. **Regulatory Asset Amortization: Unusual Operating Expenses, Including Storm Costs**
8. **Pension Asset Funding – SERP ADIT Component (see also III.B.2.a)**
9. **Income Taxes Other Than Interest Synchronization**
10. **Depreciation & Amortization Expense, Including Staff’s Withdrawn Proposal Regarding a Future Study (Other than Derivative Impacts)**
11. **Staff Proposal for Finding Regarding Non-Inclusion of Rate Case Expense in Initial Rates**
12. **Gross Revenue Conversion Factor**
- C. **Potentially Contested Issues**
 1. **Administrative and General Expenses**
 - a) **Total**
 - b) **Restricted Stock**
 - c) **Incentive Compensation**

Illinois courts have held that a utility has the burden of demonstrating a sufficient nexus between incentive compensation plan measures and a benefit to ratepayers in order to be permitted recovery of that expense. There is ample precedent making a benefit to ratepayers a condition upon which the recovery of salary-related expense depends. *Commonwealth Edison Co. v. Illinois Commerce Comm’n*, 398 Ill.App.3d 510, 517, 924 N.E.2d 1065 (2nd Dist. 2009) (rehearing denied 2010) (“*ComEd*”). In that case, the Court affirmed a Commission order that found that ComEd did not demonstrate a sufficient nexus between the earnings-per-share portion of the incentive compensation plan and a benefit to ratepayers. *ComEd*, 398 Ill.App.3d at 518.

Consistent with this case law, Section 16-108.5(c)(4)(A) of the Act conditions recovery of incentive compensation expense in a formula rate setting on evidence that the compensation is

based on “the achievement of operational metrics, including metrics related to budget controls, outage duration and frequency, safety, customer service, efficiency and productivity, and environmental compliance.” 220 ILCS 5/16-108.5(c)(4)(A). The new statute prohibits recovery of incentive compensation expense “that is based on net income or an affiliate's earnings per share”. *Id.*

AG/AARP witness Brosch proposed removal of the portion of incentive compensation expense consisting of ComEd’s share of Annual Incentive Program (“AIP”) costs that were originally incurred at Exelon Business Services Company (“BSC”) pursuant to formula driven by Earnings per Share metrics, rather than the permissible criteria specified at Section 16-108.5(c)(4)(A) of the Act. This adjustment is reflected in AG/AARP Ex. 1.3, page 4. At line 4 of that exhibit, a similar adjustment is proposed to eliminate AIP charges to ComEd from another affiliated company, Philadelphia Electric Company (“PECO”). ComEd has made no showing, and therefore failed to carry its burden of proof, to support recovery of these affiliate company charges of incentive compensation, pursuant to the recovery criteria enumerated in aforementioned new formula rate provisions of the Act. AG/AARP Ex. 1.0 at 47.

An additional adjustment to this expense category appears at line 5 of AG/AARP Ex. 1.3, page 4, related to a ComEd incentive program available to “Key Managers” that involves the awarding of “Restricted Stock” in Exelon, ComEd’s parent company. In 2010, the Company recorded jurisdictional expenses of \$1,921,000 based upon the award of 53,670 shares to Key Managers and Directors. ComEd Ex. 4.0 at 23. In response to an AG data request that sought an explanation from the Company of each of the performance criteria employed to determine the stock grant amounts for each individual recipient of stock, ComEd objected to providing the information on the grounds of relevance and privacy concerns of the individuals involved, but

noted that “while individual performance may apply in the determination of the amount of specific awards, the primary objective of the program is to attract and retain key employees.”

AG/AARP Ex. 1.11.

As noted by Mr. Brosch, incentive compensation that is paid in shares of stock, rather than cash, should be viewed as fundamentally driven by financial rather than operational metrics, since the value of such shares is tied most directly to the financial performance of the business rather than to measurement of the quality of service provided to customers. AG/AARP Ex. 1.0 at 49. Moreover, the notion that an incentive compensation expense should be recoverable because it is designed to retain employees is an argument that could be applied to any kind of employee compensation, and one that has been specifically rejected by the Appellate Court in the above-cited *ComEd* decision, calling such an alleged nexus to customer benefit “too remote.” See *ComEd*, 398 Ill.App.3d at 518. In short, the Company’s rationale hardly meets the specific criteria for incentive compensation cost recovery specified in Section 16-108.5(c)(4)(A) of the Act.

In response to this proposed adjustment, ComEd witness Martin Fruehe testified that he disagreed with Mr. Brosch’s rationale for disallowing the expense, claiming that the stock-based form of this compensation should not matter “...as long as it meets the goal of retaining key individuals.” ComEd Ex. 13.0 at 18. Mr. Fruehe, however, offered no new information that might support Commission inclusion of stock-based compensation as an operating expense.

This Company response is insufficient evidence that the program meets the criteria specified in Section 16-108.5(c)(4)(A). The little detail that has been provided by the Company to explain this program suggests that the compensation is tied to financial goals. For these

reasons, Mr. Brosch's proposed adjustments related to incentive compensation, detailed in AG/AARP Ex. 1.3, page 4, should be adopted.

d) Perquisites and Awards

In ComEd's last rate case, Docket No. 10-0467, the Commission adopted adjustments to normalize the Company's level of test year retention bonus awards, to exclude recovery of Other Stock Awards and Executive Perquisites, and to effect a 50/50 sharing of discretionary management Performance Awards. In this docket, ComEd proposes full recovery, without normalization adjustments or ratemaking disallowances, of these expenses.

In its Final Order in the 10-0467 rate case, the Commission stated:

The amount of the perquisites and awards here, during the test year, is more than the total amount for the previous three years. If the Commission did not amortize these discretionary costs of the period of time proffered by the AG/CUB, the Commission creates the incentive for utilities to 'shove' discretionary costs into the test year, in order to make it appear that the utility has less funds available than it really has. Also, while some of these awards may benefit consumers, they also undoubtedly benefit shareholders, as they reward improvements in job performance. Therefore, the AG/CUB proposals to amortize these expenses over four years, and to decrease the amount for perquisites and awards by half, is adopted. The Commission notes that ComEd has articulated no facts indicating that shareholders do not benefit from these 'perks.'

Docket No. 10-0467, Order of May 24, 2011 at 103. In this case, ComEd has provided no evidence that these costs are *not* beneficial to shareholders or that they provide any measurable benefit to ratepayers.

AG/AARP Ex. 1.3 reflects an "Adjustment to Awards and Perquisites" that includes a normalization of the much higher than average Retention Awards paid to Company employees (at lines 1 through 8), a 50% reduction in discretionary Performance Based Awards, and full removal of Other Stock Awards and Perquisites. These specific adjustments were in fact

calculated by ComEd in response to AG data request 4.08, a request that quantified the effect of applying the Commission's adjustment made to ComEd's perquisites and awards in ICC Docket No. 10-0467. *See* AG/AARP Ex. 1.11. Staff witness Ebrey and CUB witness Smith offered similar adjustments. *See* Staff Ex. 1.0 at 14-17; CUB Ex. 2.0 at 40-43.

AG/AARP witness Brosch explained that ComEd paid retention bonuses to employees in 2010 that were much larger than in any recent prior year. In order to ensure that ratepayers are not financing extraordinary levels of incentive compensation, it is appropriate and necessary to normalize the retention bonuses of \$4.3 million that were recorded in 2010 even though all of ComEd's expenses will be subject to reconciliation and true-up in future proceedings. If large and unusual amounts of Retention Awards are not consistently normalized, customers will be burdened with excessive rates until the future date when reconciliation and true-up calculations are performed and allowed to impact approved rates. AG/AARP Ex. 1.0 at 47.

ComEd witness Fruehe opposes the Other Stock Awards and Performance Based adjustments, arguing that the Other Stock Awards aid in the retention of talented employees and that Performance Based Awards are tied (at least in part) to customer service goals. He also claimed that even when retention bonus amounts are higher or lower in a particular year, "the costs of these awards will tend to even out over time." ComEd Ex. 13.0 at 30. He then suggested that if Mr. Brosch's adjustment is accepted by the Commission, the revenue requirement template should be expanded to provide for a four-year amortization of the normalized 2010 costs. *Id.*

Mr. Fruehe's explanation does not support rejection of the Other Stock and Performance Based amounts. As noted above, the Performance Based amounts adjustment provides for an appropriate 50/50 sharing of these costs, consistent with the evidence that shareholders benefit

from these programs. The Other Stock Awards adjustment appropriately recognizes the financial performance connection to stock compensation, and the lack of discernible ratepayer benefit associated with these expenses. Mr. Fruehe's request for a four-year amortization should be rejected. These excessive retention bonus awards should be adjusted to set inception rates for ComEd at a reasonable and normalized level. Mr. Brosch explained that this does not mean that the Company should not be allowed future recovery of these 2010 costs. Rather, inclusion of a more reasonable and normal cost level at this time will not create unduly large reconciliation differences in future proceedings when costs are presumably at more normal levels. AG/AARP Ex. 3.0 at 34.

In sum, Mr. Brosch's adjustment that includes a normalization of the much higher than average Retention Awards paid to Company employees (at lines 1 through 8), a 50% reduction in discretionary Performance Based Awards, and full removal of Other Stock Awards and Perquisites should be adopted.

- e) **W&S Allocator Calculation (see also III.C.2.b.2)**
- f) **Charitable Contributions**
- g) **Advertising Expense**
- 2. **Depreciation and Amortization Expense (Derivative Impacts)**
- 3. **Taxes Other Than Income, Including Property Taxes**

ComEd likewise advocates changing the established procedures that were used to allocate property taxes between the FERC transmission and ICC delivery service jurisdictions in prior Illinois rate cases, purportedly to better align jurisdictional allocation practices with FERC ratemaking policies. Ms. Houtsma proposes use of a "net plant" allocator rather than the methods previously proposed by ComEd and used in prior rate cases. This change in allocation methodologies increases the Company's tax expense by \$3.345 million. AG/AARP Ex. 1.0 at 43.

Again, ComEd provides a less than persuasive reason for changing the property tax allocation methodology that results in significantly increased revenue requirements for its delivery service customers if adopted. In response to Mr. Brosch's recommendation that the allocation methodologies used by the Commission to set current rates be retained, Ms. Houtsma testified that "the real estate tax allocation method applied in Docket 10-0467 did not necessarily produce a more accurate jurisdictional allocation than what ComEd has proposed in this instant proceeding" and the Company provides more detail about the allocation studies done in the past to allocate real estate tax expenses. *Id.* Again, this rationale falls short of providing a legitimate basis to raise the Company's revenue requirements. CUB witness Mr. Smith also recommended that ComEd's proposed jurisdictional allocation of property taxes should be reduced by \$3.345 million, consistent with the jurisdictional allocation method and findings of Docket No. 10-0467. CUB Ex. 1.0 at 58.

The Commission should reject ComEd's proposed change in allocation methodologies for its property tax expenses in the absence of any valid showing by the Company that the current methodology is not reasonably allocating such costs. The Company simply has not provided a persuasive basis for increasing its revenue requirement for delivery service customers merely to alter an allocation methodology that has been reviewed and approved in prior ICC rate cases. The Company's request to alter the current allocation methodology should be rejected.

- 4. Regulatory Asset Amortization: IEDT**
- 5. Pension Costs**
 - a) Pension Asset Funding**
 - b) Pension Expense**
- 6. Income Taxes: Interest Synchronization**
- 7. Other**

VI. RATE OF RETURN

- A. Overview, Including Overall Cost of Capital**
- B. Capital Structure**

1. Year End/Average Year Capital Structure
 2. Long-term Debt and Equity Adjustment Regarding CWIP Accruing AFUDC
 3. Equity Adjustment Regarding ComEd of Indiana
 4. Common Equity Ratio/Cap Limit
 5. Subsequent Procedure/Process Re: Capital Structure Issues
 6. Other
- C. Cost of Capital Components
1. Cost of Short-Term Debt
 2. Cost of Credit Facilities
 3. Cost of Long-Term Debt
 4. Cost of Common Equity

VII. COST OF SERVICE AND RATE DESIGN

- A. Studies Submitted Pursuant to 2010 Rate Case Order
- B. Rate Design, Including Upcoming Docket

The new formula statute requires that the rate design in this case be consistent with the Commission's most recent rate order, in this case the order entered in ICC Docket No. 10-0467.

The statute states:

Until such time as the Commission approves a different rate design and cost allocation pursuant to subsection (e) of this Section, rate design and cost allocation across customer classes shall be consistent with the Commission's most recent order regarding the participating utility's request for a general increase in its delivery services rates.

220 ILCS 5/16-108.5(c). Staff witness Peter Lazare analyzed the Company's filed rates and uncovered inconsistencies with the Commission's rate design directives related to the Residential and Watt Hour customer classes in the Commission's Final Order in ICC Docket No. 10-0467, ComEd's last rate case.

Specifically, Mr. Lazare reviewed both the Commission's rate design directives in that Order and the Company's filed rate tariffs and determined that the Company's proposed (and current) rates recover an excessive amount of costs through the fixed portion of the bill. In its 10-0467 Order, the Commission stated:

In an effort to gradually move towards more realistic cost causation and to avoid rate shock, the Commission concludes that the use of volumetric charges be reduced so that they recover 50% of fixed delivery service costs.

Order of May 24, 2011 at 232. Mr. Lazare explained that since rates for these customers consist of volumetric and fixed customer and meter charges, the decision that volumetric charges recover 50% of fixed delivery costs means that fixed customer and meter charges should recover the remaining 50% of fixed delivery costs. Staff Ex. 9.0 at 9.

But rather than filing rates that recover 50% of fixed delivery costs through the variable charges, the Company calculated customer and meter charges for this docket that collectively recover 50% of total costs for Residential and Watt Hour customers. ComEd Ex. 0.2 TB, pp. 1-3. This presents a problem, and is inconsistent with the Commission's directives, because not all of ComEd's costs (currently recovered through fixed charges) are fixed costs. Some system costs (now being recovered through the fixed portion of customer bills) are considered variable, as specifically identified by the Company. Mr. Lazare explained that the Company has identified two cost components that it considers to be variable costs: the Illinois Electricity Distribution Tax ("IEDT") and the IEDT component of Uncollectible Accounts. ICC Staff Ex. 9.0 at 10, citing ComEd's Response to AG data request 4.16. In its Order of May 24, 2011 in Docket No. 10-0467, the Commission's 10-0467 Order directly discusses the recovery of costs associated with distribution taxes and concludes as follows:

The Commission agrees with Staff that since the IEDT is related to usage, cost causation principles would argue for recovery through a per-kWh charge from all customers.

ICC Docket No. 10-0467, Order of May 24, 2011 at 285. Mr. Lazare explained that because the Commission considers the IEDT "related to usage," it should not be considered a fixed cost for the purpose of determining customer charges. Accordingly, customer charges should be based

on recovering 50% of remaining costs that are regarded as fixed costs for both the Residential and Watt Hour classes. *Id.* at 10. Given this directive, Mr. Lazare testified that while the Commission's 10-0467 Order indicates that customer charges for these two classes should be based on 50% of fixed costs, ComEd has instead chosen to base those charges on 50% of *total revenue* for each class. Because IEDT costs for each class clearly are not fixed and should be excluded from the calculation, ComEd overstates the costs on which the charges should be based and, therefore, proposes customer charges that are larger than warranted by the Commission's 10-0467 Order. *Id.*

Mr. Lazare testified that while the Company's Docket No. 10-0467 compliance rates contain fixed charges that recover 50% of revenues rather than 50% of fixed costs as required by the Order, it is now clear that the compliance rates were calculated incorrectly because they are not consistent with the language of the Order. In order to correct this inconsistency with the Docket 10-0467 Commission Order, Mr. Lazare recommended that the Commission approve a set of customer and meter charges that collectively recover 50% of fixed costs only, and thereby establish variable charges that represent a true 50% of Company fixed costs. *Id.* at 11. These alternative rates are provided in Staff Ex..9.02, attached to Mr. Lazare's Direct testimony. In that exhibit, Mr. Lazare set the customer charges for Residential and Watt Hour customers to recover 50% of revenues *net* of Distribution Taxes which ComEd, importantly, has specifically identified as variable costs in response to discovery. Staff Ex. 9.0 at 12, citing Company Response to AG 4.16. Mr Lazare designed the variable charges to recover the remainder of fixed costs. He noted, too, that the customer charges presented in Schedule 9.02 need to be revised downward to remove the IEDT component of Uncollectible Accounts, which the Company also indicated is a variable expense. *Id.*

The People and AARP agree that Mr. Lazare's revised methodology should be adopted in the current proceeding. Unlike ComEd's current filed tariffs and proposed formula rate tariffs, the Lazare modification provides consistency with the Commission's 10-0467 Order by recovering 50% of fixed costs through fixed charges and the remaining 50% through variable charges. Furthermore, it ensures that IEDT costs are recovered through per-kWh charges as approved by the Order. This alternative approach corrects the error in the Company's proposed rates, which recover 50% of total costs (including some variable charges) through fixed charges and 50% through variable charges, an approach that clearly conflicts with the Commission Order.

Id. at 12-13.

ComEd witness Ross Hemphill objects to this Staff-proposed correction to the ComEd rate design, arguing that "the time to argue that ComEd's filed rates do not comply with the Order has long since passed." ComEd Ex. 11.0 at 24. He goes on to argue that "[t]his docket is not an appropriate venue to attack that decision months later." (*Id.*)

Mr. Hemphill is wrong in that regard. As correctly noted by Mr. Lazare, there is no statute of limitations on ensuring that rates are consistent with Illinois law and Commission orders. ICC Staff Ex. 20.0 at 6-8. Mr. Lazare has clearly demonstrated that the Company's rate design tariff in this case does not comply with the Commission's specific directive to establish rates that reflect recovery of 50% of costs through the variable charges for the Residential and Watt Hour classes. Simply because Staff failed to catch ComEd's error when ComEd filed its compliance tariffs in late May of 2011 does not justify permitting tariffs that do not comply with a Commission Order to continue. Moreover, as noted above, new Section 16-108.5(c) could not be clearer in its mandate that the rate design in a formula rate proceeding be consistent with the

Commission's last rate order. Mr. Lazare's correction of this rate design inconsistency should be adopted in this docket.

C. Embedded Cost of Service Study, Including Distribution Losses

VIII. ADDITIONAL FORMULA / TARIFF ISSUES

A. Tariff Issues

- 1. Separate Statement of Earnings Collar Effect**
- 2. Calculation of Increases for Three-Year Report**
- 3. Other**

B. Ratemaking Process and Filing Issues

- 1. Access to Information re Formula Rate Filing**
- 2. Triggers for Hearing on Certain Operating Costs**
- 3. Performance Condition for Incentive Compensation Costs**
- 4. Other**

C. Reconciliation

- 1. Average Rate Base Proposals (see also III.C.1)
The Formula for the Reconciliation of the Revenue Requirement Will
Only Represent Actual Costs if Average, Not End-of-Year, Rate Base
Is Used.**

ComEd's ability to recalculate its annual revenue requirement retroactively and recover the difference between the inception revenue requirement (based on the prior year FERC Form 1 data plus projected plant additions) and that year's FERC Form 1 data is a major change in regulation. This process changes a fundamental effect of the prior regulatory system: it allows the Company to retroactively charge or credit consumers for changes in its costs that occur after the rate is set. As a result, test year principles must be rethought in order to accommodate this change in the law and regulation.

Traditionally a utility's revenue requirement is set pursuant to test year rules to estimate the utility's annual revenue needs for an indefinite future. By law, the revenue requirement cannot be changed retroactively. By contrast, the inception revenue requirement set under Section 16-108.5 is designed to be an interim revenue requirement, subject to modification after actual cost data is available on the FERC Form 1. If the actual FERC Form 1 data for the

revenue requirement year produces a higher revenue requirement than the inception revenue requirement, the difference (with interest) is added to the rates consumers pay in the next annual set of rates. It is also possible for the actual revenue requirement to be lower than the inception rates, although as AG/AARP witness Brosch pointed out, revenue requirement increases, not decreases, are expected due to the large investment commitments contained in the bill.

AG/AARP Ex. 1.0 at 10-11; 220 ILCS 5/16-108.5(b).

The question of whether the rate base to which the utility's cost of capital is applied should be measured as an average or at year-end must be considered in light of this new regulatory structure. By allowing the full recovery of costs that deviate from the inception revenue requirement, with interest, the traditional "regulatory lag" resulting from the use of a historical test year and the need to wait eleven months to change tariffed rates is eliminated. Although rates are still based on annual costs similar to the annual cost approach used in a test year, the purpose of the reconciliation revenue requirement is to retroactively match that revenue requirement with "actual costs." Therefore, the reconciliation rate base is used to calculate the "actual" cost of the capital funding rate base for the reconciliation year.

Rate base is a key component of rates, being the investment on which the utility is allowed to earn a profit. How the rate base is presented in the reconciliation docket determines how much profit and other capital costs consumers provide to shareholders and investors. In determining the *inception* revenue requirement (e.g. for 2011), the formula rate utilizes an end-of-year rate base taken from the prior FERC Form 1 year (2010), plus plant additions (for 2011). The inception revenue requirement, however, does not represent the final amount of revenues that consumers will provide the utility for the year. While using the end-of-year rate base and including the coming year's plant additions minimizes the difference between the reconciliation

revenue requirement and the inception revenue requirement, the reconciliation revenue requirement is the final calculation that is intended to represent *actual* costs. The use of an end-of-year rate base (from the former year) in determining the inception revenue requirement is the first step in setting that year's revenue requirement, but it does not compel the use of an end-of-year rate base in the reconciliation. 220 ILCS 5/16-108.5(c). The reconciliation revenue requirement and the inception revenue requirement have different functions, use different data sets, and produce different results.

Using an average rate base in the reconciliation year will properly quantify capital costs as they accumulate over the year rather than as a point in time (end-of-year) and matches other elements of the revenue requirement and income in a given year. AG/AARP Ex. 2.0 Rev. at 19.²⁷ If the cost of capital to fund that increase in rate base were calculated as of year-end, consumers would pay a return on the total annual as if that amount were funded (and a return needed) every day of the year. However, the investment can be expected to be made ratably over the course of the year – not on January 1. The effect of using a year-end rate base is to treat investment as of December 31 as if it had been made the prior January 1. This results in consumers paying a return on investment before it is made and will systematically overstate the capital cost charged to consumers. AG/AARP Ex. 1.0 at 13.

Based on the statutory \$2.6 billion investment requirement, it is reasonable to expect ComEd to incrementally increase plant investment by about \$390 million per year during the first five years of the plan. AG/AARP Ex. 1.0 at 10. The difference between the cost of funding this incremental investment using the midpoint or average investment of \$195 million versus

²⁷ AG/AARP witness Brosch pointed out that “The utility’s actual investment in new plant and the corresponding growth in newly invested equity and debt capital tend to grow gradually throughout the year. Therefore, the associated return requirement for such capital also grows gradually throughout the year.” AG/AARP Ex. 1.0 at 12-13.

using the year-end amount of \$390 million is \$25 million per year. *Id.* at 11. Stated another way, the use of year-end rate base will effectively increase the post-tax return on equity allowed by statute by 43 basis points. *Id.* at 12. The disparity would be even greater if rate base grows more than five percent per year. *Id.* Given the specific statutory formula for determining ComEd's cost of equity, see 220 ILCS 5/16-108.5(c)(3), the Commission should not allow an inadvertent increase in the authorized profit level by using year-end rather than the more representative average rate base for determining the actual, reconciled revenue requirement.

In response to the average rate base recommendation of AG/AARP witnesses Brosch and Effron, CUB witness Ralph Smith, and IIEC witness Michael Gorman, ComEd witness Houtsma argued that Section 16-108.5 (c)(6)(D)(1) justifies the use of year-end rate base. ComEd Ex. 12.0 at 32. However, the language at that section does not mention either year-end nor average rate base. In reference to the reconciliation filing, the statute states:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (as reflected in the FERC Form 1 that reports the actual costs for the prior rate year).

The statute's reference to "the actual revenue requirement for the prior rate year" emphasizes the goal of determining the *actual* costs in the reconciliation, and this intent is repeated later in the same section.²⁸ Actual rate base is by definition the average rate base because year-end rate base did not exist throughout the prior year on an actual basis. AG/AARP Ex. 3.0 at 6.

²⁸ The statute emphasizes: "Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately reconcile the revenue requirement reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the revenue requirement would have been had the actual cost information for the applicable calendar year been available at the filing date." 220 ILCS 5/16-108.5(d); HB 3036 Enrolled at 41.

ComEd witnesses also take issue with witnesses who discussed the use of average rate base values in a future test year under traditional ratemaking as supporting the use of average rate base in the reconciliation. ComEd Ex. 20.0 Surrebuttal Hemphill, ComEd Ex. 12.0 at 33-34. ComEd witness Houtsma suggests that the fact that the Company sets and collects a given year's revenue requirement after the fact, subject to later reconciliation, makes it more of a historical test year process where year-end data is used. However, Ms. Houtsma ignores the difference between the inception revenue requirement and the "actual" revenue requirement set in the reconciliation. In setting the inception revenue requirement, year-end rate base is used (plus projected plant additions). This accounts for the regulatory lag that Ms. Houtsma identified in her testimony. However, the reconciliation revenue requirement meets a very different purpose – to determine the Company's actual costs. Actual costs for an annual period are not, by definition, year-end costs. Further, by adding the difference between the inception revenue requirement and the reconciled revenue requirement to the next year's rates with interest, the Company is compensated for the short term delay in receiving its entire, actual revenue requirement, adjusted annually. The use of average rate base in a future test year provides insight into why an average rate base is more accurate than year-end, but because the reconciliation revenue requirement is unique, the use of average vs. year-end rate base in the reconciliation must be reviewed in light of the goal of determining actual costs consistent with the return on equity calculation in the statute. ComEd's approach should be rejected because it will systematically overstate both ComEd's revenue requirement and its return on equity.

ComEd Exhibit 22.1, Schedule FR A-1 Rec shows the format the Company proposes to use to calculate the reconciliation revenue requirement. In order to properly use the average rate base in the formula, a line should be inserted into that Schedule after line 12, which currently

refers to the year-end rate base from the FERC Form 1. The new line would insert the year-end rate base from the prior year, and a second line would be inserted to average the two. AG/AARP Ex. 1.0 at 15. As Mr. Brosch pointed out, conforming changes would be needed within the Rate DSPP to properly give effect to the average rate base approach. *Id.*

2. Interest Rate Proposals

The Commission should adopt either the short term interest rate for the reconciled revenue requirement or the interest rate on customer deposits.

As explained above, the difference between the inception revenue requirement and the reconciled, actual revenue requirement is added to the next year's inception rates, with interest, so that the utility receives the "actual" cost of service from consumers. The relevant section states:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (as reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year). Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d).²⁹ In contrast to the specific return on equity described elsewhere in Section 16-108.5, the drafters of this subsection did not specify the interest rate to apply to the reconciliation amount and did not refer to either the return on equity or any other measure of capital cost. Accordingly, the Commission must determine the appropriate interest to apply to reconciliation amounts based on the nature of the cost.

The formula prepared by ComEd would have consumers pay ComEd its weighted average cost of capital on any reconciliation amount. ComEd Ex. 22.1, Sch. FR-A-1-REC; AG/AARP Ex. 1.0 at 16. In addition to not being authorized by the statute, which calls for

²⁹ HB 3036 Enrolled, page 40.

simple “interest,” this is an excessive interest rate and does not represent the actual cost of capital for the short period of time that the reconciliation amount will be outstanding before its guaranteed recovery under the formula.

The potential reconciliation amount will not be known until the review of the actual data for the revenue requirement is presented, and will be set for recovery for the next annual rate year. As such, the known balance will be collected within the year following the determination of the reconciliation amount. This represents a short term obligation (as it can be a credit or a charge) and will not require permanent funding or additional equity financing like the long term assets ordinarily require. See AG/AARP Ex, 1.0 at 17. The interest rate on the reconciliation amounts should not be inflated by treating them like long term assets.

There is a substantial difference between the cost of short term debt, long term debt, and equity financing. As shown in Staff witness Phipps testimony, the cost of capital varies considerably:

Short term debt:	0.72%
Long term debt:	6.42%
Common equity:	10.05%

Staff Ex. 7.0, Sch. 7.01. Given the certainty of recovery of the reconciliation amount and the short period of time that it will be outstanding, there is no reason to believe that the actual cost of that money will be more than the short term debt cost. Further, the inclusion of projected plant additions in the annual revenue requirement calculations should minimize the discrepancies between the inception revenue requirement and the reconciliation revenue requirement, resulting in only a modest outstanding balance requiring interest, again indicating that only a short term interest rate is appropriate.

A further refinement of the calculation of interest is necessary. It is reasonable to assume that the majority of the reconciliation amount, or true-up, will be caused by changes in operating expenses. AG/AARP Ex. 1.0 at 19. The Commission can treat the reconciliation amount as a regulatory asset, and the deferred income tax balances associated with these expense deferrals should be used to reduce the balance on which interest is accrued. *Id.* at 19. AG/AARP witness Brosch explained how to modify the ComEd formula tariff found in ComEd Ex. 22.1, Sch. FR A-4 to implement this approach as follows:

First, the “Variance” appearing at line 3 should be reduced by associated incremental deferred income taxes using the Company’s composite Effective Income Tax Rate, which is derived on Schedule FR C-4, line 8. The calculation and subtraction of related Accumulated Deferred Income Taxes could be inserted as new lines 4 and 5 on Sch. FR A-4. Then, the “Monthly Interest Rate” on line 4 (to be renumbered line 6) could be modified to tie to ComEd’s calculated current cost of short term debt as determined at App 12 of the template.

AG/AARP Ex. 1.0 at 19-20.

In the alternative, the People do not oppose the recommendation of the Staff that the interest for the reconciliation amount be set at the rate for customer deposits. The Staff correctly points out that other ComEd reconciliations carry the customer deposit interest rate. Staff Ex. 1.0 at 17-18 (citing ComEd Riders PE, BESH, AMP, RCA, and UF). Although the interest rate on customer deposits is now 0, that rate reflects the fact that interest rates are at historical lows. Pegging the interest on formula reconciliations to the customer deposit rate will track the short term cost of capital, and be consistent with other revenue adjustment riders utilized by ComEd.

Conclusion

- 3. Regulatory Asset/Deferred Expense Recommendation**
- 4. Other**
- D. Other Proposals and Position Regarding Formula, Tariff Schedules and Attachments, and Processess**

- IX. Other
 - A. Distribution System Loss Study
 - B. Study Report #5

X. Conclusion

For the foregoing reasons, the People of the State of Illinois and AARP request that the Commission issue an order consistent with the positions stated above.

The People of the State of Illinois

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